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Economic and Political Results for 2001 and Prospects for Strengthening Economic Growth

1. *Results of the first decade of post-Communist reform*

The year 2001 concluded the first decade of post-Communist transformation, Russia's development in a regime of market democracy. The period witnessed difficult and complex processes of the transformation of Soviet socialism into a new society. A tortuous and contradictory path gave rise to acrimonious debate about the very nature of reform, its effectiveness and appropriateness, about whether there were alternative ways of meeting the challenges that the country was facing.

One of the key points of the debate of the 90s was to what extent the Russian problems were unique to this country, whether they were inherent in the historical experience as well as national and cultural features of Russia's development, and, accordingly, to what extent universal approaches and the experience of other countries were applicable in developing and implementing the program of post-Communist restructuring. This is all the more important because an answer to these questions makes it possible to summarise the results of the first post-Communist decade and formulate some important problems of Russia's further progress towards the market and democracy.

At the end of the 80s Russia (rather, the USSR) encountered four formidable challenges associated with four different transformation processes. It was those processes that determined the country's development throughout the 90s. While not necessarily interrelated per se, they proved to be intertwined in Russia, substantially affecting each other, and, more importantly, the economic and political development of the country.

First, Russia was faced with the challenges of the post-industrial epoch. Transition from an industrial to a post-industrial society is accompanied by severe structural and macroeconomic crises, such as those the Western countries experienced from the 70s onwards. Thanks to the favourable conditions of world markets, the USSR could delay the beginning of structural adjustment, only to experience even more painful adjustment when there was no longer any escaping it. The structural crisis of the Soviet economic system, at the height of which came a drastic decline of the now Russian economy, resulted from the same processes, which with reference to Western countries in the 70s were described as "stagflation". [1]

Intense discussions about the nature of structural transformation continued throughout the 90s. Some authors described the output drop in certain conventional sectors of the economy as deindustrialization, although a more in-depth analysis of the ongoing processes allows the nucleus of a new, post-industrial structure to be discerned in the structural change that is going on currently (see Table 1). Telecommunications and electronic industries are booming [2] (since 1998 the latter has been growing by as much as one third annually). Change to more advanced products is going on in the chemical and metallurgical industries. The number of educational institutions is increasing markedly, as are the numbers of undergraduate and post graduate students. Of course, this trend is not absolutely predominant, and whether it will be sustained or not will greatly depend on the efficiency of economic policy and on the government's ability to promote favourable change.

Table 1. Some indicators of social and economic development in the 90s (1991 = 100% unless stated otherwise), %

Source: Goskomstat

	1992	1998	1999	2000
Education				
Number of universities	103.3	176.1	180.8	185.9
Number of university students	95.5	130.3	147.5	171.6
Number of university graduates	104.4	123	136.3	156
Number of faculty members	1993=100%	115.4	121.7	125.5
Production				
Video-cassettes	107.7	1157	944	807.5
Share of sophisticated products in the paint and varnish industry	72	82	85	86
Share of electric arc steel and oxygen-converter steel in total steel production, %	50	72	72	73
Share of continuous casting steel products, %	28	52	50	49.7
Production of aluminum	99.4	111.4	117	120.6
Transport				
Cars per 1,000 population	107.9	192.1	201.7	208.5
Metalled roads per 1,000 square meters of territory	103.3	111.1	111.3	111.6

Tele-communications				
Number of general access telephone lines	101.6	123.8	130.7	135.2
Number of household telephone lines per 100 households	105	137.6	147.6	155.5
Total length of long-distance telephone channels	106.3	252.8	351.1	509.1
Share of digital telephone channels in total long-distance telephone channels, %	1.5	56.9	69.1	76.9
Number of registered fax-machines	206.2	1706 (1997)		
Number of pagers	100	3838	4118	5065
Number of cellular phones	100	12695	23600	55524

Second: there was post-Communist transformation as such going on in Russian society. This was a truly unique experiment. Never in world history (including the history of economics) has there been a transition from a totally state-controlled to a market economy. Of course, the most difficult was transformation of ownership, i.e. privatization on a national scale. However, this sort of transition was not peculiar to Russia. Post-Communist change was simultaneously going on in about 25 countries. What is more, Russia was not a pioneer in this respect: a number of countries had embarked on such transition two or three years earlier, which provided the post-Soviet republics with some, although not very rich, experience.

Third: Russia was faced with a full-blown macroeconomic crisis resulting from populist economic policies (beginning in the second half of the 80s), which led to the breakdown of the fiscal and monetary systems, extremely high inflation and output decline. It has to be mentioned, however, that the phenomenon of macroeconomic crisis and ways of handling it had been thoroughly studied by the end of the twentieth century. In the post-war period many European, Asian and Latin American countries had to grapple with similar problems. Moreover, Russia itself had a certain positive experience of pulling out of a macroeconomic crisis in 1922-1923.

Fourth and last, the politico-economic, macroeconomic and structural changes that Russia faced at the turn of the 90s were accompanied by a full-scale social revolution. Systemic transformation, which changed the social set-up of the country radically, was being brought about in a situation of a weak state, which in fact is one defining characteristic of a revolution. [3] By the time post-Communist change began, practically every institution of the state had been all but destroyed, and their restoration was essentially the central political objective of the first post-Communist decade. Moreover, economic reform advanced only to the extent that the institutions of the state were restored, which made the pace of reform much slower than in most other post-Communist countries. Among the countries undergoing post-Communist transition revolutionary transformation was a unique Russian feature, though it was not entirely new in European history.

Thus, Russia's development in the last decade was indeed quite peculiar. But this specificity was due not so much to cultural and historical factors as to the very fact that the above four processes were simultaneous. There was nothing unique or unknown about each of those processes from the experience of other countries or from Russia's own historic experience. What was unique was their combination in the same country at the same time. It is this combination that gave rise to the peculiar processes which determined the specificity of Russian transformation and puzzled many scholars dealing with issues of post-Communism.

At the end of the nineties signs emerged that at least three of the four transformation processes had run their course.

First of all, *macroeconomic stabilization had been achieved.* The crisis was quite protracted (lasting about ten years) but not unprecedented in economic history. Stabilization was brought about through an array of standard measures (liberalization, fiscal and monetary restraint), and its success paved the way for resumption of economic growth.

Of course, stabilization was not achieved once and for all. An economic system is not guaranteed against mistakes by the authorities, against unsound and populist decisions. In 1999–2000 the government successfully passed its first serious macroeconomic test, i.e. coping with favourable prices for Russian exports.

The processes of revolutionary transformation have been practically completed. The restoration of the state is very much in evidence. Macroeconomic stabilization has gone in step with political stabilization. In 1999, the analysis of political parties' pre-election programs showed the reference points of the main political groups to be converging [4], however important the differences between them. A common system of fundamental political values, which are above political dispute, is emerging. Specifically, no one calls into question private property as the basis of economic and political life (although appraisal of the outcome of privatization still arouses controversy); no one calls for an end to tight monetary and fiscal policies. (Until quite recently inflationary financing of the budget deficit was widely thought to be acceptable); all groups (even on the left) support the policy of alleviating the tax burden, everyone accepts the need to shift the emphasis of policy to implementation of deep institutional reform. Of course, practical recommendations of political groups still differ substantially but those differences are no longer so deep as to constitute a threat to political stability. The ability of the authorities to secure basic macroeconomic stability is the most important politico-economic characteristic suggesting that the crisis has been overcome. [5]

The year 2001 brought new elements to the pattern of post-revolutionary politico-economic stabilization currently taking shape in Russia. While 2000 saw the emergence of *de facto* domination of the Duma by the executive branch, which could rely on support of either the right or the left (depending on the nature of proposed legislation), now a steady pro-government majority is being formed in the Lower House. Now practically every new bill sponsored by the government can rely on support in parliament, which is very important for further operation of the political regime. On the one hand, there is less political haggling over each specific bill, hence more consistent pursuit of the government's chosen course. On the other hand, a system of relations between the government (relying on its parliamentary majority) and the opposition (the parliamentary minority) is assuming the form typical of stable democratic societies.

One could further claim that *the goals of post-Communist transformation have been successfully accomplished.* This conclusion tends to provoke especially strong objections and, therefore, needs to be clarified. The Communist system was distinguished by three main political characteristics: a totalitarian political regime, absolute domination of state ownership in the economy, and shortage of goods as a basic constituent of economic and political life. [6] By the end of the 90s three main features of Communism had been eliminated in Russia. Of course, this does not at all mean that Russia had fully overcome the crisis that ushered it into the nineties. However, severe structural and macroeconomic problems which Russia is still facing and which make it vulnerable to external shocks, are not, strictly speaking, a legacy of the Communist system. They reflect rather the development and crisis of the industrial system, and it is no accident that practically all countries which have had to cope with transition from an industrial to a post-industrial society have faced similar problems and challenges.

To sum up, the dominant socio-economic problem confronting the present-day Russia is the crisis of the industrial system and establishment of the socio-economic basis of a post-industrial society. This process defines the main challenges that the country will need to meet in the coming decade.

2. *Politico-economic results of 2001.*

Institutional changes have become the focus of the current stage of economic reform, coming to the fore now that the task of microeconomic stabilization has been successfully accomplished. Strictly speaking, during the first post-Communist decade issues concerned with establishment of a new system of institutions also played an important role (since privatization is one of the most significant institutional changes). [7] However, institutional change could not have become more purpose-oriented and consistent before the goals of economic and political stabilization had been achieved. This is only natural, since social and economic instability tends to undermine the normal working of economic institutions, primarily that of private property.

2001 saw the first steps towards implementation of the Strategic Program, whose development was initiated by V. Putin in 2000 and which has become known as the Gref Program. The 10-year program is supposed to be detailed in documents covering a shorter period and containing the list of laws to be developed and adopted year by year. Accordingly, in the summer of 2000 a package of measures for 2000–2001 was approved. These were implemented in 2001 (following some revision). In the spring of 2001 a program of measures for implementation in 2002–

2004 was approved. [8]

The objectives covered hitherto include tax reform, fiscal reform, the Land Code, the labour legislation, pensions reform, deregulation (streamlining of red tape), reform of natural monopolies, banking reform, reform of customs legislation, development of financial markets and moves towards WTO accession. Unification of legislation across the country (elimination of regional separatism), judicial reform and reform of government machinery were to become important political components of economic reform. All these changes aimed to *establish a favourable investment and business climate, thereby providing the basis for sustainable economic growth.*

The sheer scope of the agenda threatened practical implementation of the program, dispersing efforts and preventing concentration on specific economic and political problems to be addressed. Even without this the dilemmas of implementation were severe enough.

On the one hand, the fastest possible implementation (or at least the beginning of implementation) of the bulk of planned changes had to be secured, both because of the political cycle (initial confidence and goodwill available to President Putin) and a kind of "revolution of rising expectations" affecting the general public along with investors. *On the other hand,* institutional reform is much more individualized and country-specific and, therefore, requires much more extensive technical (economic and legal) groundwork than financial stabilization (where practically universal international experience is available); hence, it took much longer to prepare. At the same time, identification of priorities and concentration of efforts on their practical (political) translation into at least draft laws turned out to be a problem with no theoretical solution.

All this was reflected in a peculiar sequence of events around implementation of the 2000-2001 program. Immediately after the appointment of Mr. Putin's administration and M. Kasyanov's government in May 2000, important steps to restructure federal relations and change the tax system were undertaken. Reform of the Federation Council and establishment of the institution of the President's authorized representatives in the federal *okrugs* (larger regions) were to promote unification of law across the country. A drastic cut in the personal income tax rate and introduction of a regressive payroll tax showed the willingness of the authorities to take resolute steps to improve the economic climate.

However, after these first two steps had been taken, the pace of reform implementation slowed. What followed was protracted coordination of draft documents between government agencies and interest groups represented in parliament. The above-mentioned technical difficulties of developing and drafting laws and regulations, many of them without precedent in the practices of other countries, also played a part. Deregulation, reform of natural monopolies, banking reform, etc., required not only declarations of general principles but also a host of concrete documents explicitly interpreted and built into the Russian legal framework.

None of this was surprising. However, political consequences of such a slow-down in the pace of reform could have been quite detrimental. Investors, although they welcomed the Strategic Program, from the very start doubted the government's ability to put it into practice. Those doubts seemed to have been confirmed. Out of more than one hundred items in the Program planned for implementation in 2000–2001, little more than a dozen were fully implemented. [9] Many had only just been approved by the government after lengthy coordination and were unlikely to be accepted by the Duma deputies, since some government agencies intended to oppose their adoption on their admission to the Duma.

The package of deregulation laws was making its way through the Government with difficulty, as it affected the interests of most of the agencies who were unwilling to cede any of their powers. The new sections of the Tax Code (primarily the corporate profits tax) were languishing in the Duma committees, which launched a practically endless process of reconciling interests of individual industries and sectors of the economy, all of them with powerful lobbying potential and seeking to secure the maximum number of tax breaks by referring to the peculiarities of their respective industries and the need to boost investment there. Taxation of mineral resources hit similar snags; demands to allow for innumerable special factors in relation to mineral deposits made the taxation system cumbersome and susceptible to corruption. Pensions and labour legislation was also bogged down in coordination and reconciliation procedures. Three versions of the new Labour Code collided in the Duma. Reform of the electricity monopoly UES stirred up fierce infighting within the executive branch itself, with regional governors summoned by the authorities as possible umpires. The new system of customs tariffs developed and approved by the government failed to be put into effect.

True, the concept of railway reform was approved, but the transformation model selected was based on the ideas originally put forward by the Railway Ministry (establishment of a super-monopoly called The Russian Joint-Stock Company Railway as the starting point of reform), which raised doubts about the transparency and effectiveness of further steps.

Finally, the row at the beginning of 2001 over the repayment of debt to the Paris Club did nothing to enhance the image of the new wave of Russian reform. Everything pointed to poor judgment here: an attempted unilateral refusal to pay the debt and a bitter debate within the executive branch (between the Government and Presidential Administration) that was conducted publicly, followed by reversal of the initial decision. Even though the final decision to comply with the debt repayment schedule was plainly sensible, such vacillation by the authorities always harms their image in the eyes of the public.

Summing up the situation, by the spring of 2001 it had become evident that swift action was wanted to improve the outlook drastically. And before long signs emerged of a new phase of consolidation of power being carried out in two directions.

On one side, political institutions were reconfigured. The Federation Council was transformed into a standing body. A semi-formal association named *Federation* was established, made up of members of the Upper House, committed to consistent support for the initiatives of the executive branch and effectively holding a majority stake in the Federation Council. Thus the tacit rule that the Upper House is non-partisan and focused only on the interests of the regions was set aside.

Parallel processes were in progress in the State Duma. The consolidation of *Yedinstvo* (Unity), *Otechestvo* (Fatherland) and *Vsya Rossiya* (All Russia) into a national party meant the establishment of a pro-presidential majority in the Lower House. Earlier, in 2000, this majority had been secured *de facto* – pro-presidential factions could always form alliances with the right or the left; but to secure support for government initiatives, agreement had to be sought and majority formed for each individual bill. By contrast, in the new situation any initiative of the executive branch automatically gets support. So for the first time in recent Russian history a majority government holds office in the country.

Of course, this substantially simplifies implementation of government policy. However, the responsibility of the Cabinet for the quality of bills put forward by government agencies has been drastically increased, for now the introduction of bills in the Duma is likely to switch on "the voting machine". Especially, because, strictly speaking, the parliamentary majority supports the government as a proxy for the President. This support is to a large extent personal and non-ideological. Therefore, thorough evaluation of proposed bills in parliament becomes much less likely; the source of the bill being more important to the parliamentary majority than its substance. Hence it is with the Government that the real decision making as regards economic policy will now rest.

On the other side, the progress of amendment and passage in the Duma of socio-economic bills has been considerably streamlined. The government agencies were urged to agree and approve documents speedily. Draft laws on deregulation and pensions reform were laid before the Duma. The executive branch agreed in some measure to meet the legislators halfway. This primarily concerned the Land Code, from which the section on the sale of agricultural land was deleted. With regard to the Labour Code the compromise was more formal than real – it was based on a draft elaborated by some Duma deputies but very close to the Government approach.

Finally, there was a breakthrough in the area of tax legislation comparable with the achievements of 2000. After protracted and fruitless debate over the profit tax rates and a variety of tax breaks the Government and the Duma ventured upon a decisive step: the corporate profits tax was cut drastically to 24% with practically all tax breaks, including investment credits, abolished. Similar decisions were made with regard to mineral taxes, which were consolidated in a single tax, with its administration radically simplified.

Some progress was also achieved in the reform of natural monopolies. The Government approved the outline of the railway and UES (electricity monopoly) reform and replaced the top management of Gazprom. Of course, this is only the beginning, and the outline proposals themselves draw sharp criticism from various political and economic groups. So far, however, only the preliminary stage of reform is being implemented, involving the drafting of the laws, to be submitted to the Government and introduced into the Duma. What kind transformation is really intended will become apparent after the drafts have been produced and presented to legislators for debate.

Thus, work to establish the legal framework of proposed institutional reform is in full swing. While it has made noticeable progress, a real breakthrough has yet to be achieved. A number of aspects of legislative work, their successful development or, *au contraire*, obstruction, can be regarded as a touchstone of the effective advance of reform. Those aspects include:

- adoption of the law on the of sale of agricultural land. The main issue here is, of course, whether the executive branch will be willing to insist that the clause in the Constitution on private ownership of real estate should be applied to agricultural land;

- prospects for the adoption of the Civil Code. The principal issues in this respect are the approval of the third part of the Civil Code and amendments reducing the statute of limitation as regards privatizations from ten years to three;

- further steps to adopt the Tax Code;

- adoption of the pensions legislation, which is under consideration by the Duma. Especially important is the issue concerning schemes for private pension funds, operation, their competitive operation and stability on the market;

- prospects for further progress in deregulation. Approval of laws on registration, licensing and inspections and audits is only the first step. These laws need to be made effectual by amending laws and regulations governing the operation of the police, sanitary inspectorate and other agencies, and also by adopting a further package of laws on the regulation of entrepreneurship (certification and standardization, self-regulated organizations).

Achievement of these goals will be an important step towards establishment in Russia of an institutional system consistent with the idea of market democracy in a post-industrial era. However, important as those goals are, they do not exhaust the list of top priorities, which the country will have to address in 2002 and which will dominate the agenda of the executive authorities in the run-up to the elections.

3 Strategic priorities of socio-economic policy in the present-day Russia as part of impending reform

The focus of Russia's current and medium-term economic policy is the creation of conditions for fast economic growth in parallel with restructuring of the economy in the spirit of post-industrialism. This implies addressing the problems of "catching-up". Russia faced problems of this nature about a century ago but that was in relation to challenges of the industrial era. The problem of catching-up development is a matter for separate study, going far beyond the scope of this article. Here we consider only those elements of policy, which have clearly come to the forefront.

There has been a new turn in the debate on mechanisms for achieving sustainable growth. When the Strategic Program was being prepared in 2000, three key alternatives strategies were put forward: a dirigiste one (involving enhancement of the regulatory and redistributive role of the government, through its direct participation in investment); a liberal one involving drastic reduction in the government budget's share of the economy) and an institutional one (development and enforcement of "rules of the game", encouraging businesses and investors to operate in Russia). [10] In its Strategic Program the Government opted for the third of these approaches. However, actual developments in the sphere both of economic policy and business have placed further questions on the agenda.

A need to choose between three alternatives resurfaced. The first alternative is active industrial policy by the government; the second – enhancement of the role of major conglomerate enterprises of the biggest companies (financial-industrial groups or vertically integrated companies) in investment (and organization in general), and third – development and strengthening of institutions of a modern market democracy. The three approaches are genetically related to at least two of the three alternative strategies listed above. The main difference is that whereas the debate in 2000 was somewhat speculative and mostly based on economists' ideas of the best way to develop, the focus now is on actual current developments in Russia's economy.

Two specific trends are discernible. First, the government is determinedly pursuing institutional transformation in an effort to improve the business climate. Second, establishment of vertically integrated companies has been stepped up. Such enterprises made up of an assortment of businesses and banks, are starting to pursue active investment policies. A more favourable investment climate is believed to be prevalent within such agglomerations, since investment within a corporate organization avoids the heavy transaction costs caused by the government's inability to secure contract enforcement. [11] It is only natural that a public debate should have begun on ways of boosting economic growth and overcoming constraints (or negative trends) of the two policy approaches.

Active government industrial policy implies identification of structural priorities (primarily sectors) and promotion of investment; substantial expansion of government demand and its use as a major factor in enhancing business activity; real appreciation of the rouble to encourage imports of machinery and components and possibly support for import substituting industries through measures of tariff policy. Reliance on integrated business groups is inseparable from this model, since they can be regarded as instruments and vehicles of government industrial policy. [12] The main drawbacks of this model are first, that in a post-industrial economy it is impossible in principle to select industries as priority targets for support; and, secondly, the high cost of mistakes in making such a choice, plus the low efficiency of government investment, which has been proved repeatedly in practice. In addition, industrial-financial conglomerates tend to impose their interests on society both by "nationalizing losses" and by persuading the authorities to substantially restrict competition from foreign companies as much as possible.

Under the alternative strategy, the government intensifies efforts to attract private investment in both export-oriented and import-substituting industries. This should be pursued through macroeconomic, institutional and foreign (diplomatic) policies. Unlike the first model, macroeconomic policy seeks to curtail real appreciation of the rouble and lower the share of the budget in the economy (but with the budget expanding in absolute terms). Efforts are stepped up to provide investor incentives – both general (lowering of the tax burden, removal of bureaucratic barriers to business, improvement of the judicial system efficiency, etc.) and specific (free economic zones, production sharing agreements, etc.). Finally, activities are undertaken to extend Russia's involvement in the relevant international organizations and harmonize national business legislation with that of other market economies.

In real life the two economic policy models are not entirely incompatible. [13] They are, of course, alternatives, but political practice can to a certain degree combine them, neutralising certain drawbacks and making the most of their respective merits. For example, under certain circumstances government demand could be used as a tool for economic growth, so long as this demand is not founded on fiscal populism or dependent on provision by the monetary authorities of credit to the budget. It goes without saying that the course of events does not depend exclusively on government decisions, which are themselves limited by national economic conditions.

It may be accepted as highly probable that expansion of vertically integrated companies will be a feature of Russia's development in the years ahead and that they will likely play an important role both in investment and on the political scene. This means that the government should accompany these developments with measures of macroeconomic and institutional policy designed to support investment by financial-industrial groups while at the same time curbing their monopoly powers. The authorities have enough levers to deal with the problem.

If developments follow such a scenario (as seems likely), three areas of policy decision for the authorities will acquire a particular significance.

The first is consistent implementation of liberal foreign trade policy. The key element here is WTO accession. Openness of the Russian market to competition from foreign producers is one of the principal ways to counteract monopoly tendencies of major domestic companies. It is not accidental that in 2001 some of those companies stepped up their efforts to oppose Russia's WTO accession. At the same time, progress toward this goal does not mean rejection of any kind of protection of domestic producers, for instance protection offered through measures of exchange rate policy.

Second, what becomes extremely relevant is implementation of deep reforms in the realms which go beyond the economy as such but which have a substantial (sometimes even decisive) impact on economic activity. Those are reform of the judicial system, reform of government machinery (including law enforcement) and military reform. Positive change in these areas affects the overall business climate in the country (first of all, reduction of transaction costs) as well as forestalling attempts by major companies to acquire control over government institutions.

The third area is encouragement to business enterprises. Central to this area is anti-trust policy and promotion of competition. Deregulation issues (lowering of administrative barriers to business), as well as stimulus to innovation and to small businesses, are especially important. All these are factors contributing to the creation of a favourable institutional market environment for post-industrial society.

The above three target areas define the priorities of government socio-economic policy over the next few years.

4. *European economic institutions as guidelines for medium-term institutional reforms.*

2001 saw an event which may become crucial for the development of post-Communist Russia: The EU put forward the idea to establish of a Common European Economic Area.

The notion of the EU-RF free trade zone was formulated already in the Partnership and Cooperation Agreement (PCA), which was signed in Corfu on June 24, 1994, and became effective on December 1, 1997. One of the stated goals of the Agreement was "to create the necessary conditions for the future establishment of a free trade area between the Community and Russia covering substantially all trade in goods between them, as well as conditions for bringing about freedom of establishment of companies, of cross-border trade in services and of capital movements". In 1998 it was planned to study the question of whether the time was ripe for beginning talks on the FTA.

The goal of "Russia's integration into a common European economic and social area" was formulated in the Common Strategy of the EU on Russia (3–4 June 1999), which refers to "the future establishment of an *EU-RF free-trade area*" and subsequently of the *Common European Economic Area* as a result of gradual approximation of legislation and standards.

There are still many points that need to be further spelled out and clarified in these proposals. [14] However, for all the existing vagueness and lack of detail, as well as technical and legal problems, which practical implementation of this idea are bound to encounter, the importance of the declaration on establishing a common economic area can hardly be overestimated. In effect, we are talking about development of key institutional guidelines for the socio-economic transformation of Russia, a sort of key-note of post-Communist reform. For the first time since the collapse of Communism, Russian society may come to recognize and formulate its own long-term development path. If this is truly the case, then Russia will at one and the same time define criteria for appraising politico-economic decisions and results of their implementation.

It is precisely the adaptation to Russian conditions of European institutions that is the aim of the Strategic Program to 2010. The objective can now be detailed and presented in an explicit form. In describing the goals of medium-term development, the criteria of Russia's accession to the European Union may be viewed as strategic targets. They may also be regarded as institutional objectives which Russia intends to achieve within the next 10–15 years. These criteria are rather fully worked out and are in line with the cultural and economic development of present-day Russia. The level of economic development and education, GDP structure, the social structure of population, and for that matter the current political system, make the choice of European standards the most natural and appropriate.

The conclusion that European standards should be used applied, requires, however, some qualification.

First, the use of these parameters as the basic ones should not be identified with the goal of EU accession. The latter is a political issue, and Russian society is not yet ready to discuss it.

Second, the parameters are still quite vague today. Further work is needed to adapt the Maastricht and Copenhagen criteria, as well as special reports by the European Commission (evaluating the degree of preparedness of individual some countries) for more detailed targets to be developed for Russia.

Third, *all* the criteria should be applied to actual Russian realities and practices. As it happens, Russia is already ahead of the EU as regards some socio-economic decisions or institutions. This is true of the tax system, fiscal policy (orientation to a zero-deficit budget), and labour legislation. It should also be recognized that Russia's current agricultural policy (meaning essentially, the principles of relations between the government and the agricultural sector) is more efficiency-oriented than that of the EU. There should also be no formal alignment of Russian institutions with European ones if that were to impair Russia's competitive advantages.

Fourth, we need standards developed in Russia and for Russia. There can be no question of parameters being developed jointly with the EU or under control of European entities. The idea is that Russia should determine its own targets and goals rather than formalize its desire to join the EU.

Remaining within the economic framework, adaptation of European standards should be undertaken primarily in the following areas: 1) existence of a functioning market economy; 2) ability to secure effective competition and operation of market forces (deregulation and establishment of competitive conditions, legislative stability and transparency of fiscal policy); implementation of structural reform with a focus on protection of property rights, effectiveness of bankruptcy legislation, efficiency of the tax system, stability of the banking sector, and of financial markets; 4)monetary and fiscal policies to promote steady growth; 5) establishment of administrative and government institutions in line with European standards. Financial standards are specified by the Maastricht agreements: 1) price stability: annual inflation within 1.5 percentage points of the three best performing EU countries; 2) annual government deficit not to exceed 3% of GDP; 3) debt: total outstanding government debt not to exceed 60% of GDP; 4) exchange-rate stability, meaning that for at least 2 years the country concerned has kept within the "normal" fluctuation margins of 2.5% envisaged by the European Exchange Rate Mechanism; 5) average nominal long term interest rate must be within 2 percentage points of the average rate in the three countries with the lowest inflation rates.

Based on the above list of issues, of special importance today is fulfilment of the criteria associated with the establishment of a functioning market economy, ability to secure effective competition and operation of market forces, structural reform and adaptation of standards. Administrative reform is also of interest to the extent that it is not concerned with procedures directly related to EU accession.

The complex of goals relating to macroeconomic conditions have not, of course, ceased to be important; but these problems have become much less grave in recent years. It is easy to see that with respect to some criteria Russia now looks to much tougher parameters than EU membership requires.

If developments follow a favourable scenario, Russia's position in Europe could, in a strategic perspective, be similar to the current partnership between the EU and Norway (looking here to the precedent rather than to specific forms).

Russia's accession to the WTO and the OECD (formal application to the OECD was filed as long ago as as 1996) are natural stations on the way to the European-type institutions.

5. *Economic challenges of the present situation*

11 September and the slowdown of the world economy are two key factors that will determine the development of the Russian economy in 2002. However dramatic those developments may be, their impact on the domestic economy is not to be viewed as unequivocally negative. For apart from external factors, there is a conscious reaction of the authorities, a range of tools for alleviating negative consequences, and sometimes even turning them to the country's advantage.

Let us point out that the political circumstances are currently turning in Russia's favour. September 11 gave strong impetus to rapprochement with the West. The drop in oil prices, although painful from the fiscal perspective, may turn out to be an important incentive to step up structural reform. [15] Thus, a lot depends on the appropriateness of the government's action, its ability to make effective decisions in responding to the situation.

Given the deterioration of world economic conditions and the resulting drop in prices of major Russian exports, the main problem for the country is not to let the situation develop according to a populist scenario. All the more so because their developments tend to encourage populist decisions in an attempt to support economic growth.

In our view, today's circumstances call for the following principal measures to be taken by the Russian authorities.

In the area of *monetary policy,* it would make sense to allow market forces to bring about gradual real depreciation of the rouble. This is advisable on two grounds. First, this would strengthen the position of domestic producers on the internal market, where real appreciation of the rouble in 2000–2001 has weakened that position substantially. Second, it would prevent a drastic decline in the country's foreign reserves. Third, a low real exchange rate should help to boost investment inflows (the slowdown of the world economy is not the best possible environment for this but given the amount of capital that fled the country previously, the potential for its repatriation remains quite strong). Fourth, such a policy would not provoke speculative attacks on the rouble.

Au contraire, strengthening of the rouble or maintenance of the current exchange rate would place too great a strain on Russia's foreign reserves, requiring tougher customs control (when resources are more than modest in this area). Besides, such a policy would most probably undermine the financial sector's confidence in the monetary authorities, since the available foreign reserves and forthcoming debt payments would not allow the Central Bank to defend the strong rouble for long, thus making attacks on the rouble almost inevitable.

In the area of *fiscal policy* the maneuver needed is, without renouncing the principle of a balanced budget, apply budgetary resources more efficiently in support of economic activity. This will be feasible only in conjunction with if deep reform of the public sector is implemented. The breakthrough in revenue collection (on the tax front) achieved over the last two years now needs to be supplemented by sound decisions on budgetary expenditure. What is meant is not necessarily expenditure cuts but a variety of organizational, political and structural measures to secure substantial improvement in the effectiveness of budget spending. The role and functions of the principal budget beneficiaries, budgeting procedures, etc. need to be revised. This could provide the basis for using budget resources to support the economy through their concentration on areas most conducive to growth.

It should be reiterated that we are not opposed to the idea of using government demand for encouragement of economic activity. We are saying only that this policy cannot be effective with the current structure of budget beneficiaries and the current revenue allocation procedures. That is why budget spending reform is now an important and even crucial priority for the government. Such reform could become the key link in tackling structural transformation of the country and decreasing its dependence on world energy prices.

Implementation of these reforms will increase the importance of changes in the above mentioned extra-economic areas, which are nevertheless closely related to economic: judicial, administrative and military. The first of these constitutes the main institutional prerequisite for development of stable business activity in Russia, supplementing measures of fiscal and monetary policies in the drive to secure repatriation of the capital that has fled the country. The second and third items are extremely important areas for improving the efficiency of budget spending.

Finally, in a situation of falling oil prices and political rapprochement with the West, all these measures would allow talks on restructuring and perhaps a partial write-off of the Soviet debt to be revitalized. This aspect should be borne in mind as decisions on cooperation with OPEC and oil export cuts are taken.

Overall, the Russian government has successfully passed the test of high oil prices, having resisted populist measures, where consequences are only too familiar. Now, however, Russia faces a new test, that of low prices for its main export commodities. If we pass it successfully, without substantial economic and political destabilization, it will mean that Russia has decisively overcome the crises of transition, that its elite has consolidated and the country is capable of stable operation in the post-industrial world.

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[1] Description of the Russian crisis as the crisis of an industrial society is found in a number of papers (see: Bauman Z. A Post-Modern Revolution? // From a One-Party State to Democracy. Amsterdam : Rodopi, 1993; Rosser J.B., Rosser M.V. Schumpeterian Evolutionary Dynamics and the Collapse of Soviet-Block Socialism // Review of Political Economy. 1997. Vol. 9. № 2).

[2] In the 90s the electronic industry introduced about 700 new state-of-the-art products and started manufacturing 800 new consumer products. In 1999 output growth was 46%, in 2000 – 37,7%. Exports of electronic products have grown dramatically over recent years to $70 mln–$80 mln annually, mainly to non-CIS countries. (See Smirnov, B.Bolshiye perspektivy mikrotekhnologiy i skhem //Krasnaya zvezda. 2001. March 17; Smirnov B. Rossiyskaya elektronika – bogach i bednyak. 2001. April 17.

[3] For more detail see Mau and V.A. Starodubrovskaya I.V.,The Challenge of Revolution, OUP, 2001.

[4] IET. Rossiyskaya ekonomika v 1999 godu: Tendentsii i perspektivy. V.: IEPP, 2000, pp. 313–319; Dmitriyev M. Evolutsiya ekonomicheskikh program veduschikh politicheskikh partiy i blokov // Voprosy ekonomiki. 2000. No 1.

[5] High inflation is not only an economic but also a political indicator. Indeed, inability of the authorities to implement a variety of macroeconomic stabilization measures results from their weakness and resulting dependence on the balance of various interest groups seeking soft monetary and fiscal policies. This is exactly why macroeconomic stabilization hinges on a strengthening of political institutions, and hence is one of the most important criteria of political stabilization.

[6] The inseparable link between Communism system and shortage of goods was shown at the very start of the Communist experiment (see Brutskus B.D. Problemy narodnogo khozaystava pri sotsialisticheskom stroye // Ekonomist.

1922. No 1–3; Novozhilov V.V. Nedostatok tovarov // Vestnik finansov. 1926 No 2). Curiously, it was in fact acknowledged by J. Stalin. In “Economic Fundamentals of Socialism in the USSR” “the law of the faster growth of needs compared to ability to meet them” is referred to as one of the fundamental laws of society built under his guidance. (Stalin J. Works. Volume 16.: Pisatel, 1997).

[7] Hence one cannot help wondering at repeated accusations by the critics of Russian reform that the reformers of the 90s underestimated the importance of institutional change.

[8] The main documents were as follows:

- Principal directions of short-term socio-economic policy of the RF Government (approved at the meeting of the RF Government on June 28 2000);

- Plan of the RF Government’s activities in 2000–2001 with regard to social policy and modernization of the economy (approved by the RF Government order No 1072-r of July 26, 2000), amended by the RF Government order No 933-r of July 14, 2001);

- Strategy of Russia’s socio-economic development for the period up to 2010 (discussed by the RF Government and submitted to the RF President in May 2001);

- Program of medium-term socio-economic development 2002–2004 (approved by the order of the RF Government No 910-r of July 10 2001).

[9] To be more specific, out of 119 items in the Government action plan 78 items were to have been implemented by March 15, 2001. Actually only 51 measures had been implemented in full or in part by that time. In practice this meant that most of the documents that were to have been issued, were still being refined or coordinated within the government itself. At the same time, many of them were draft laws that were subject to passage through the Federal Assembly (Monitoring of the progress of the Program implementation was conducted by the Russian European Centre for Economic Policy (RECEP).

[10] For details see: IEPP. Rossiyskaya ekonomika v 2000 godu: tendentsii i perspektivy. M., IEPP, 2001, p. 18.

[11] For details see: Dynkin A.A., Sokolov A.A. Integrirovannyie biznes-gruppy – proryv k modernizatsii strany. M., 2001, p. 13

[12] A. Belousov offers probably the most accurate and balanced description of such a model; “This approach requires clear economic policy seeking encouragement of consumption and investment, and, of course, it rules out any rouble devaluation. The main constraint here is poor competitiveness of the domestically oriented sector, which is unlikely to be improved rapidly without a consistent government industrial policy”. (Ekonomicheskaya konyunktura v oktyabre-noyabre: Obzor makroekonomicheskikh tendentsiy No 32/ Tsentr makroekonomicheskogo analiza I kratkosrochnogo prognozirovaniya. M., 2001).

[13] Incidentally, this is where the current situation differs from most of the 90s. At the first stage of post-Communist change different interest and political groups put forward absolutely incompatible demands with respect to economic policies: inflationary injections of money into the economy versus stabilization based on a tight monetary policy, a zero-deficit budget versus budget-funded support for domestic producers, liberalization of foreign trade versus tough protectionist measures. The list could be extended almost *ad infinitum*.

[14] In fact there is a European Economic Area (EAA) already, incorporating the EU countries, as well as Norway, Iceland and Liechtenstein. The last three countries are also part of the European Free Trade Area. The EEA membership implies not only establishment of “the common market” but also substantial progress towards harmonization of legislation. The EEA membership effectively means adoption by the member states of the EU legislation and standards. At the same time, the EEA does not envisage establishment of supranational bodies (except for the dispute settlement mechanism).

[15] Recent economic literature has argued convincingly that in today’s world economic prosperity is achieved mostly by countries poor in natural resources. Lacking in cheap and readily usable resources, those countries and their governments of whatever complexion have to put an emphasis on productivity, productive efficiency and competitiveness, thereby securing growth on a sound basis (See Gaidar E., Anomalii ekonomicheskogo rosta. M. Yevraziya, 1996; Gylafson Th., Zoega G. Natural Resources and Economic Growth: The Role of Investment: CEPR, 2001.