

Key measures for a transition to economic growth in Russia

by Sergei Glazyev

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The present situation

The main reasons for the continuing economic collapse and the destruction of Russia's scientific and technological capacities are gross errors in macroeconomic policy, which produced several vicious circles of cause and effect, establishing conditions for the prolongation of depression and the contraction of economic reproduction.

The first circle: disintegration of the economy, and the debt crisis. The shift of the money supply into speculation, due to the extremely high returns there (financial pyramids, speculation on the shares of privatized enterprises, currency speculation, speculation on GKO's [Russian Treasury bills]), and the suppression of inflation by means of restricting the money supply, caused the departure of money from the real sector of the economy and, consequently, a payments crisis and a budget crisis. In effect, the country's economy decomposed into two loosely connected spheres—the speculative financial, and the productive—the former being characterized by rapid growth and the concentration of wealth and capital, while the latter, playing the role of donor for the former, is in a state of deep depression and decline.

The state policy of promoting and supporting speculative instruments of market regulation, particularly the emission of super-high-yield state bonds and the build-up of the state debt, resulted in an even more rapid outflow of capital from the productive sphere into GKO speculation, a further aggravation of the payments crisis, and a decrease of tax revenues. At the present time, the economy has landed in a debt crisis trap, where current expenditures to service the state debt are more than double Federal tax revenues, which necessitates a continuous growth of borrowing, at a rate of increase of 1.5 times per year. Servicing the state debt has become the largest item of budget spending; the state debt has turned from a mitigating factor in the budget crisis, into a powerful factor of its exacerbation, compounding the crisis both directly (through the increase of budget spending) and indirectly (through aggravation of the payments crisis).

The second circle: collapse of demand, curtailment of production, increase of costs, and decline of competitiveness. With the restriction of the money supply, the reduction of aggregate demand provoked cost inflation and a collapse of

production, which aggravated the growth of costs. Cost inflation reached its extreme point, with the establishment of price proportions that are highly unfavorable for the productive sector. Along with the depressive effect of contracting demand, a vicious circle of production decline took shape:

rise of raw materials prices above world levels—
increase of costs in the manufacturing industries—
decline of the competitiveness of domestic manufacturers—
their displacement by imported goods—
decline of production—
increase of costs—
deterioration of the financial situation of enterprises in the real sector of the economy—
lowering of wages—
reduction of demand—
collapse of production, and so forth.

The pernicious influence of this cycle was significantly compounded by the policy of raising the real exchange rate of the ruble. This factor alone caused a more than sixfold decrease in the competitiveness of domestic goods, by comparison with analogous imports.

The first two vicious circles induce a third: the lowering of production efficiency and reduction of investments. The reduced scale of production leads to a decrease of its efficiency, to the deterioration of the financial condition of producing enterprises, and to the loss of their ability to invest. The reduction of investment, in turn, results in a further decline of efficiency and competitiveness, which leads to a still greater collapse of production.

The fourth circle: Bankruptcy of productive enterprises, loss of national control over them, and the colonization of the country bring full circle this negative feedback, which perpetuates the process of economic depression and the degradation of the productive sector. The de facto failure of mass privatization as an instrument for the creation of effective property-owners, against the backdrop of the outflow of capital from the productive sector and the disintegration of the economy, encouraged the development of predatory motivations in business behavior: the establishment of control over an enterprise, privatized for a song, for the purpose of looting it or reselling it to competitors. The latter are usually foreign companies, interested in establishing control of the relevant segments of the domestic market, or in eliminating potential Russian competitors on the world market. As a result, privatization most

often has brought with it not an increase in management efficiency, but, rather, the opposite: Firms are squeezed for their liquid resources, efficiency is reduced, bankruptcy ensues, or surrender to control by foreign competitors.

At present, an unstable equilibrium has been attained in the economic system, which is expressed in the suppression of inflation, zero growth, and the stabilization of the exchange rate of the ruble. Under conditions of continuing depression in the productive sphere and the reduction of investments, this balance is maintained by means of “hot monies” being artificially tied up in the speculative sphere, through the build-up of the state debt “pyramid.” In order to maintain this balance, the Central Bank and the government, so as to prevent the growth of aggregate demand on the currency and commodities markets, are forced to guarantee high returns on investments in the state debt “pyramid,” and to divert a large part of the monetary emission and one-fourth of all Federal budget spending, for these purposes. By maintaining such high returns on speculative operations (not below 20% annual interest), however, in the setting of the declining profitability (down to a level of 7%) and abiding high risk of financing industrial enterprises, the Central Bank effectively blocks any influx of capital into the productive sphere or growth of investments, which are out of the question, given such a correlation of economic valuations.

The following parameters of the current state of macroeconomic equilibrium have been empirically determined:

GKO yields	20-30%
Central Bank refinancing rate	20-30%
Profitability in the productive sector	5-7%

Capacity utilization in industry	around 40%
Unemployment (including implicit)	10-15%
Inflation	around 10%

Prognosis

It is obvious, that in the present state of equilibrium, there can be no growth of productive investments, revival of industrial production, or improvement in the general economic situation, due to the insuperable gap between yields on speculative operations and profitability in the productive sector. The Central Bank’s most recent actions, in raising the refinancing rate and, accordingly, the return on GKO’s, confirm that this equilibrium can only be maintained at yield levels that are out of reach for industrial investments, and that it is achieved at the cost of a rapid growth of the state debt, the immobilization of the population’s savings, increase in Federal budget spending for debt service, and an outflow of capital from the sphere of production. Therefore, the longer the current balance persists, the worse the state of the productive sector and investment activity. The 7% decline of investments and 1.5-fold growth of debts in default, a 14.5% (50.6 trillion rubles) increase of losses in the sphere of production, the insolvency of half of all producing enterprises, along with the increase of the state debt by more than 100 trillion rubles — these are the costs of maintaining this equilibrium during last year [1997].

To maintain this balance during 1998, will require the emission of over 100 billion new rubles [redenomination of the ruble occurred on Jan. 1, 1998, with the removal of three zeroes] worth of new bonds, as well as the 124.1 billion rubles in Federal budget spending, included in the draft Federal budget for the current year. But even this amount may be insuffi-

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Elected to the new parliament, the State Duma, in December 1993 from the Democratic Party of Russia, Sergei Glazyev headed its Economic Policy Committee until 1995, then worked at the Security Council during 1996. Dr. Glazyev has maintained his association with the Central Mathematical Economics Institute (CEMI) of the Russian Academy of Sciences, where he undertook his post-graduate studies. His April 1996 report to CEMI’s Scientific Council, “The Theory of Economic Growth in a Transitional Economy,” was excerpted in *EIR*, May 31, 1996.



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cient to service the augmented “pyramid” of state securities; the government is demanding to be granted the right arbitrarily to reallocate unprotected budgeted expenditures in favor of servicing the state debt, announcing that additional required allocations for this purpose may run from 25 up to 40 billion new rubles. Depending on tax collection rates, this may result in the sequestration of 20-50% of unprotected budget spending, which in effect would mean the final destruction of the state budget system.

Alternatives would be a relatively greater monetary emission, for the purpose of purchasing state bonds, or increased borrowing abroad. The GKO pyramid has far exceeded the limits of sustainability; during this year or next, the balance maintained at such a high price will be “exploded” by the financial bankruptcy of the state, which is inevitable under such a policy. Moreover, the longer the balance is maintained, the more severe will be the consequences of the crash. To escape from the debt crisis will require either tens of billions of dollars of new, emergency borrowings, or a shift to a policy of economic mobilization, accompanied by relapses into the command-administrative system. The cost of such actions will be, respectively, either the final loss of national sovereignty in economic, defense, and foreign policy, or an abrupt deterioration of the population’s standard of living. In any event, an uncontrolled debt crisis will bring about the latest serious destabilization of the economic system, wiping out the value of the huge sacrifices made for the policy of stabilization in the preceding period.

Guidelines

A continuation of the policy of passive accommodation to the debt crisis and economic depression, by building up the state debt and budget spending on debt service, will lead to the speedy bankruptcy of the state’s financial system, with extremely grave political and social consequences. Therefore, measures should be adopted, first of all, to make the debt crisis manageable and, secondly, to create real conditions for economic growth and to bring some stability, on that basis, to the country’s socio-economic development. Accordingly, some short- and medium-term guidelines are in order.

The short-term guidelines should provide, first of all, for a way out of the debt and budget crises. They include: an increase in Federal budget revenues by at least one-third; a twofold reduction of spending on state debt service; a sharp reduction of new short-term borrowing.

The medium-term guidelines are defined by the President’s official directions on the transition to economic growth. They provide for: the achievement of stable annual GDP growth rates of 5-7%; a sharp increase of investments, at a rate of not less than 25% per annum, including an increase of investments in science-intensive industry and new technologies at up to 40% per annum; while inflation is brought down to an annual 15-25%. Additional social guidelines are: growth

of the population’s incomes at an annual rate of 3-4%, reduction of unemployment to no higher than 5%, a significant mitigation of social stratification, and the elimination of mass poverty.

In the framework of the present macroeconomic policy, it is impossible to achieve, or even approximate, these goals. At the same time, the officials who are implementing this policy today are incapable of changing it, due, first of all, to their incompetence; secondly, to their strong dependence on the influence of foreign capital, and pressure from the leading Western countries and heads of international financial institutions; thirdly, to their personal interest in its continuation; and, fourthly, to their fear of being removed from power, in the event of a revision of the policy they have implemented.

These are the reasons that explain why the leaders of the government and the Central Bank strongly reject all proposals for solving the budget and debt crises, put forward by the scientific community, business circles, or the Houses of the Federal Assembly, and ignore the obvious threats to national economic security. Therefore, attainment of the above-indicated economic policy goals and implementation of the President’s directions on a transition to economic growth, will demand a significant cadre improvement in the top leadership of state bodies responsible for the formulation and implementation of economic policy.

In order to shift to economic growth, a system of measures should be adopted, that ensure: overcoming of the gap between the spheres of production and of finance; a change in price proportions, favorable to manufacturing industries; an increase of demand; a rise in the competitiveness and efficiency of domestic production; a sharp increase of investment activity; reconstruction of the economy on the basis of spreading the next technological mode;¹ exit from the budget and debt crises. The implementation of these measures presumes departure from the present state of equilibrium, which will likely be accompanied by a temporary worsening of the inflation rate, will require restructuring of the state debt, and will cause certain problems with creditors and international financial institutions. A transition to economic growth also presumes a cardinal change of economic policy priorities, entailing significant alterations of proportions in the distribution and appropriation of the national income,² in favor of wages,

1. The author uses terminology from the so-called long-wave school of economic research, initiated by the Russian N.D. Kondratieff (1892 until his 1930s death in a Siberian prison camp), and continued by Harvard’s Joseph Schumpeter (1882-1950) in his 1939 book, *Business Cycles*, and others. Dr. Glazyev terms successive sets of technological innovations, dominating the economy during given periods, each as a distinct *uklad*, which may be translated as “structure,” “mode,” or even “vintage.”

2. “National income” (*natsionalny dokhod*) is an economic reporting category used in the Soviet Union and Russia. It denotes the value added in a year by all branches of production—in Soviet usage, only material production and productive services.

the state budget, and productive investments, and it will also require serious political support, in order to overcome the resistance of the financial oligarchy.

A medium-term economic growth policy presumes the creation of general macroeconomic conditions and the application of special measures, oriented toward launching an upswing of investment and production activity. At the same time, short-term policy, along with the adoption of these measures, should be directed toward a speedy solution for the tasks of overcoming the budget and debt crises, which means

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a cardinal change of budget and credit policy priorities, the adoption of measures to restructure the state debt, and the mobilization of additional budget revenues.

General conditions

The prerequisite for the creation of general conditions for economic growth is an essential change in the general principles of economic policy and the rejection of a number of dogmas, which have reduced macroeconomic regulation to primitive formal procedures of directive monetary planning, which only serve to compound the crisis. Economic policy should become complex and systemic, subsuming not only the monetary, but also investment, structural, industrial, foreign trade, science and technology, and other components, necessary to provide the prerequisites for economic growth under present conditions. It must provide a way to overcome the disintegration of the economic system, to chart the economic reproductive growth curves for the transformation of savings into investments, to restore normal circulation of payments, and to raise the competitiveness of Russian producing entities. A brief outline of the principal elements of an economic growth policy is presented below.

1. With respect to monetary and credit policy, a shift must be made from the primitive policy of formally planning increases of the money supply, to a complex policy that maintains a rate of interest favorable for productive investments and the restoration of enterprises' circulating capital, while

maintaining a supply of money that is adequate to ensure payments, and pushing foreign currency and monetary surrogates out of domestic payments circulation.

Such a transition means a significantly more complex technology for monetary planning and regulation. In particular, the movement of the money supply should be planned as an estimated value, rather than as a specifically targetted value, in accord with the actual demand for monetary resources, not only on the financial markets, but also in the sphere of production. Considering the disintegration of the economic system that has taken place, regulation of monetary circulation should be conducted in a differentiated manner, including measures for the targetted regulation of monetary flows, to keep them in the real sector of the economy, the attraction of productive investments, and the replenishment of enterprises' circulating capital. This may be accomplished by means of the introduction of investment accounts, norms of crediting, targetted regulation of monetary emission within established limits, differentiation of reserve requirements depending on real operations, provision of state guarantees, and the utilization of a multitude of other instruments, aimed to attract and hold money in the productive sphere, and to stimulate investments in production.

In monetary policy, it is necessary to raise the role of qualitative parameters (interest rates, first and foremost), moving toward planning them in a differentiated way, which takes into consideration the needs of various spheres of economic activity, characterized by different rates of monetary circulation and different degrees to which inflation depends on the dynamics of money availability. Above all, this involves consideration of the needs of the productive sector for monetary resources, to restore the normal circulation of capital and provide for an upswing of investment activity. When estimating the correct level of monetary supply to the sphere of circulation, it is necessary to take into account the additional demand for money, connected with desirable measures to dedollarize the economy and expand the use of rubles for international payments, as well as with the growth of the securities market and the entry of land and raw materials deposits into market circulation.

Measures must be adopted to localize and eliminate the payments crisis. In particular, it is necessary finally to solve the problems of organizing credit circulation, shifting to electronic payments, and restructuring the indebtedness of major debtors.

2. Regarding a policy to regulate financial markets and exit from the debt crisis, measures should be taken to decrease the return on, and hence the attractiveness of, speculative operations, not associated with investments in production. The artificial measures that have raised the profitability and reduced the risk of operations in the sphere of circulation should be abolished, such as: the Central Bank's provision of services like holding commercial banks' free resources in

Central Bank deposit accounts, or the enlistment of direct commercial bank credits for purposes of financing budget spending, with government guarantees. There should be an end to the various machinations that “cycle” budget funds through privileged banks, and so forth. At the same time, state guarantees should be expanded for the attraction of investment credits. It is also appropriate to introduce a system of state guarantees for the population’s deposits in banks that meet prescribed minimum norms for extending credits to the productive sector.

Here must be a cardinal decrease of the yields on state bonds, at least to a level comparable with world standards. In order to eliminate the anti-investment effect of the state bond “pyramid,” their yields need to be brought down to a level, not exceeding the profit rate in the productive sector, which is no higher 7% per year in real terms.

It will be impossible to avert a crash of the GKO financial “pyramid” without restructuring it, so as to restore some correspondence between the current obligations of the state and the possibilities for them to be serviced. One necessary element of this restructuring should be a freeze on servicing GKO held by the Central Bank; these may be written off, or transformed into long-term, interest-free bonds. It is necessary to end the absurd situation, where the Central Bank grows super-rich, by allocating emitted money for the purchase of GKO and appropriates huge profits at the expense of the Federal budget. Furthermore, some of the bonds that are in the hands of state-controlled banks can be restructured by means of converting short-term into long-term obligations. There may also be special negotiations with the domestic banks that are the biggest holders of state bonds, on mutually acceptable terms for restructuring them. Without such measures, it will be impossible to stop the spontaneous growth of the GKO “pyramid” and reduce the cost of servicing it, which means to reduce returns on the financial markets to a level acceptable for industrial investments.

The reduction of profitability and restructuring of these bonds will result in a decline of demand for them, and, consequently, will aggravate the problem of financing the Federal budget deficit. This problem will be partially solved, on the one hand, by the reduction of spending to service and pay off that part of the state debt, which is owned by the Central Bank and other state agencies, and, as well, by measures to increase non-tax budget revenues, indicated below. At the same time, in order to reduce the debt burden and associated budget outlays, it is necessary to resume the practice of using interest-free Central Bank credits to finance the cash gaps between budget revenues and expenditures within a year, which are determined by objective seasonal factors in the Russian economy.

Considering the negative influence of the high domestic debt on Russia’s credit rating, which worsened after the highly disadvantageous (for Russia) write-off of the greater

part of its foreign financial assets as a condition for joining the Paris Club,³ it seems appropriate to write off the economically senseless part of the domestic debt held by the Central Bank (repayment arrears on state credits for the support of the economy, deliveries to the North, etc.), and to begin negotiations on writing off part of Russia’s foreign debt, which by 2003 it will not be able to afford to service.

In connection with the inevitable reduction of demand for GKO, as their yields decline, compensatory measures should

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be adopted. For instance, the Central Bank could count some portion of investments in state securities as deductions from the mandatory reserves of commercial banks that purchase such securities, and could introduce rules, obliging insurance companies to hold part of their assets in the form of state securities, and so forth.

Measures to restructure the state debt may result in a temporary decrease of financial market stability. In the absence of such measures, however, the market will experience catastrophic destabilization. In any event, it makes sense to introduce mechanisms to counter destabilizing influences on the part of big speculators, which would include a procedure to halt the free repatriation of capital, a temporary cessation of foreign currency sales, flexible devaluation of the ruble, etc.

3. Tax reform and overcoming the budget crisis. Tax reform should provide for: reduction of the tax burden to no

3. Russia’s membership in the Paris Club of creditor nations was finalized in September 1997, on terms that included the write-off of Soviet-era debts owed to Russia by developing sector and other foreign countries.

higher than a combined rate of 35% for taxes on value added, profit, and wages; tax exemption for the part of profits, earmarked for improvements in production and assimilation of new technologies, scientific research and development, and replenishing of enterprises' circulating capital; a twofold reduction of the value-added tax; simplification of the tax system; use of automatic tax payment procedures, rather than declarative; redistribution of the tax burden from poor citizens to those with high and superhigh incomes.

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jected in the proposed tax reform, should be compensated by an expansion of the tax base, as a result of shutting down the "shadow economy" and the general animation of industry; the elimination of all privileges and exemptions from paying customs duties, the value-added tax, and duties on imported goods; the increase of taxes on luxury items; higher taxation of socially and environmentally harmful kinds of activity, speculative operations and income derived from property; the regulation of the alcohol market, in accordance with the adopted Federal law "On State Regulation of Production and Circulation of Ethyl Spirits and Alcoholic Products," as well as the activation of non-tax sources of budget revenue.

Among the latter, the most important is natural rent, the major part of which should be collected as state budget revenue — by means of appropriate resource payments and the use of an export tariff for the collection of natural rent on exported natural gas and some other raw materials with a low degree of processing. As an alternative or a supplement to the export tariff, a state monopoly may be introduced on the export of these commodities, for the purpose of confiscating the relevant excessive profits into the state budget.

In budget policy, all overt and covert forms of legalized embezzlement should be halted ("cycling" of budget appropriations through privileged banks; replacement of budget

appropriations by commercial bank credits guaranteed by the Ministry of Finance; holding of reserves for servicing the state debt, in privileged commercial banks, etc.). Budget expenditures should be managed through the Treasury and the Central Bank.

In their totality, these measures could increase Federal budget revenues by one-fourth, while reducing unproductive spending to the same degree. This would double the efficiency of the budget system, which is quite sufficient to solve the budget crisis and make real tax reform possible.

4. The reform of the pension system entails transition to a system of personal accounts, and the simultaneous development of a system of non-state pension funds, with the introduction of appropriate state guarantees and tax exemption of voluntary contributions to pension insurance. The pension reform plan approved by the government can be considered satisfactory, albeit belated.

5. Respecting anti-monopoly policy, it is necessary to tighten price controls on the raw materials and natural monopolies, holding the growth of these prices to one-half the general level of price inflation, and to introduce strict regulation, up to and including a state monopoly, of electricity and natural gas distribution and railroad transport services, in order to prevent costs from being overstated. The major task in this area is to level out price proportions, for the purpose of raising the profitability of industrial and agricultural enterprises, creating a basis for the expansion of production.

6. The decriminalization of economic activity, by means of strengthening state protection for property rights, responsibility for observing contract discipline, improving the efficiency of the system for settlement of economic conflicts in the courts, more stringent responsibility for the fulfillment of contractual obligations and repayment of credits. There must be a cardinal improvement in the efficiency of the judicial system, with elimination of the corruption that is corroding it.

7. Defense of the interests of the Russian manufacturer, in foreign trade: elimination of unfair foreign competition, employing both customs duties and non-tariff restrictions; restoration of strict quality controls for imported goods; introduction of limits on foreign investment in national security-sensitive branches of industry and fields of activity (the defense industry, exploitation of raw materials deposits, telecommunications, trade, finance, the electric power industry, etc.); formation of a customs union with CIS [Commonwealth of Independent States] member countries, with Russia playing the leading role.

The currency exchange rate is a significant element of foreign trade policy. The strategy, implemented up until now, of raising the real exchange rate [of the ruble] has led to a more than sixfold decline in the competitiveness of domestic products during the past four years. As soon as possible, exchange rate policy must be brought into correspondence with the requirements of ensuring the competitiveness of domestic goods. This implies, in particular, the need for a 20-30% de-

valuation, and subsequent maintenance of the exchange rate in some correspondence with the domestic rate of devaluation of the ruble. In the present situation of a debt crisis, this policy should be designed in tandem with solutions to the problem of decreasing the cost of servicing the domestic debt.

Trade policy should be linked with industrial and structural policy, creating conditions for the development of promising industries, utilization of existing scientific-industrial capacities, and incentives for productive investments. It should be not so much protectionist, as aimed at realizing the competitive advantages of Russia's manufacturing enterprises, especially science-intensive ones. In particular, this implies the introduction of a full-scale system of state support measures for science-intensive exports (state-guaranteed export credits, subsidies for standardization, quality-control and quality-improvement programs, marketing programs, active support through diplomacy, and so forth), as well as the restoration of controllability and efficiency in the system of military-technical cooperation.

8. An active industrial, structural, and science and technology policy is a necessary component of an economic growth policy. It subsumes the following: definition of priorities of long-term technological-economic development, credit privileges, by means of state guarantees, for its implementation, implementation of state investment and science and technology programs, and the cultivation of leading national projects as locomotives for economic growth.

Conditions must be created for the efficient organization of industrial production, the integration of finance capital with industrial enterprises, including through the elimination of contrived limitations on mutual co-ownership between financial and industrial entities, mergers and combinations of enterprises, scientific research, and financial organizations. It is important to stimulate the establishment of finance and industry groups, capable of surviving on their own under conditions of domestic instability and tough international competition; the process of privatization of the remaining state-owned shares of enterprises should be exploited for the purpose of forming an efficient and competitive structure for the organization of industry.

The reorganization of industrial enterprises, including in the defense industry, should be oriented toward the improvement of their competitiveness and the creation of new opportunities for their development, rather than being limited to analysis of their financial condition and bankruptcies, as is the case at present.

A significant element of industrial policy should be state purchases and state guarantees for investments in purchases of domestic-produced capital-intensive equipment (aircraft, ships, agricultural implements, etc.), for subsequent leasing to the companies that use it. There should also be an absolute halt to the use of budget funds to import products, if analogous goods are produced in Russia and the CIS countries.

There should obviously be priority state support for the

conversion of science-intensive industry and incentives for scientific and technological progress, by means of a sharp increase in state subsidies for R&D and the adoption of a real program for structural reorganization of the economy on the basis of new technologies, in which specific priority lines of work are defined and which receives state budgetary and administrative support, as well as the active use of the development budget. An important element of this policy should be the deliberate shaping of coherent reproduction contours for modern macrotechnologies, in order to achieve the maxi-

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mum effect in systematic penetration of the relevant segments of the world market.

Measures should be adopted for the preservation and development of industry's technological potential, including:

- elaboration of Federal programs for the development and dissemination of key technologies of the new technological mode;
- creation of a mechanism to stimulate the transfer of new technologies from the defense industry to the civilian sector;
- identification and support for the development of technologies that will provide Russian companies with competitive advantages on the world market;
- elaboration and implementation of development programs for regions with a high concentration of scientific and technological potential (technopolises and science cities);
- improved functioning of the export control system, an active state policy for the prevention of industrial espionage and the illegal export of promising scientific technologies, and defense of domestic science-intensive firms from unscrupulous foreign competition;
- state-supported creation of infrastructure to facilitate commercialization of the results of R&D.

At the same time, it is necessary to begin the retooling and modernization of those state-subsidized enterprises and branches of industry that are deemed economically ineffec-

tive and do not correspond to the goals of the structural policy being implemented. In regions with a high concentration of depressed industries, it is appropriate to create preferential terms for economic activity and investment, including by the establishment of free economic zones.

Special measures should also be adopted for the preservation of scientific and technological potential:

- protection of state spending on science and incentives for scientific and technological progress, against devaluation and cuts, and fixing of the portion of budget spending, allocated for R&D, at no lower than 3% of GDP;

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- incentives for innovation activity, such as state support to risky start-up projects for promising innovations;
- a transition from the financing of scientific institutions, to financing R&D on a competitive basis, in accord with priority lines for formation of the new technological mode;
- preservation of the information infrastructure for scientific research work, support for the network of science and technology libraries, subsidies for spending by scientific research organizations on the use of information networks and databases and on the purchase of scientific literature from abroad;
- support for the functioning of testing units, experimental devices, and pilot production;
- active involvement of the scientific potential of CIS countries, in the implementation of priority lines of scientific and technological progress;
- subsidized spending on the protection of intellectual property and the establishment of intellectual property rights, in Russia and abroad.

The entire economic policy of the state should be oriented toward realization of the competitive advantages of the Russian economy. World experience with successful structural economic changes shows that support for those areas of the national economy, which can be drivers of economic growth

on a world-market scale, is a key aspect of structural reorganization.

Implementation of the above-mentioned measures will create favorable overall conditions for a positive shift in the economic situation and for overcoming the crisis. But, in and of themselves, they will not break the vicious circles by which the depression is perpetuated, as described above, which will undercut the positive effect of the proposed measures and continue to exert a depressive influence on the national economy. To break those vicious circles will require strong initiating impulses, capable of abruptly shifting the current conjuncture and redirecting money flows into the productive sector. Special measures for this purpose are proposed below: measures to stimulate investment activity (introduction of investment accounts, with the deployment of development institutions); stimulation of aggregate demand by the directed activation of state purchases and a restitution program for citizens' savings; a system of measures to dedollarize the economy; establishment of order in the area of state property.

Special measures

1. Measures to stimulate investment activity include:
 - introduction of a special regime for the channeling of enterprises' depreciation allowances and funds that are tax-exempt because they are earmarked for investment purposes, through a system of investment accounts, where use of the funds accumulated in such accounts is limited exclusively to capital construction and equipment purchases;
 - restriction of the emission of securities exclusively to raising funds for productive capital investment, which must be accumulated in investment accounts;
 - creation of special development institutions, which provide financing for investment projects on preferential terms, and enjoy state support in the form of state guarantees, the ability to utilize the population's resources that are on deposit in the Sberbank [state Savings Bank], and the management of companies' investment accounts;
 - active exploitation of the development budget, and the credit guarantees that it provides, for the purpose of attracting private investment in production;
 - exemption from taxes, for any profits of enterprises that are used for purposes of investment and R&D, and are entered in investment accounts;
 - channeling of monetary emission through the system of investment accounts or investment contracts with commercial banks, meaning the mandatory "cycling" of additional emitted monies through productive investments, before they appear on the consumer market;
 - restructuring of the state debt, by means of paying off previously issued bonds through investment accounts.

Introduction of this system of measures will make it possible to organize the return of capital to the productive sphere, and to establish control over money flows, preventing capital

flight out of the productive sector, back into speculative operations and abroad. Certain shortcomings in the system of investment accounts are justified by the absence of any other realistic proposals for a cardinal increase in investment activity, under present conditions of economic disintegration. These shortcomings may be partly compensated by flexible mechanisms for organizing the circulation of monetary resources in investment accounts, including market mechanisms for their conversion into regular rubles.

2. Stimulation of aggregate demand. Under conditions of very low capacity utilization in industry (around 40%) and productive enterprises' virtually total loss of circulating capital, a transition toward economic growth presumes the adoption of a system of measures to stimulate aggregate demand. These measures should be linked, in their direction, with the priorities of industrial and structural policy, and should be economically highly efficient. They should provide for the stimulation of consumer demand and a targetted activation of state purchases.

2.1. The stimulation of consumer demand includes raising real wages and restitution of the population's savings.

The increase of labor remuneration requires the strict enforcement, as well as improvement, of labor laws, and also includes measures to expand employment and utilize industrial capacities, in the framework of the industrial, structural, and investment policy. It is important for the expansion of consumer demand to be achieved through purchases of domestic, not imported goods, which requires appropriate measures to protect the domestic market, above all against the dumping of poor-quality goods and other forms of unscrupulous competition.

A powerful lever for expanding consumer demand and thus increasing the utilization of production capacities, lies in a properly organized restitution program for the population's savings. For this purpose, the use of citizens' savings in the Sberbank, restored in correspondence with the purchasing power of their mid-1991 deposits,⁴ should be restricted to three purposes: purchase of domestically produced consumer durables; investment in housing or production; payment of a certain portion of housing and utilities debts. In each of these areas, there will be a registration of payments, for the purpose of monitoring the correspondence of their aggregate volume to the planned limits on the increase of the money supply or consumer demand. The supply price of the relevant products should be fixed in advance. Simultaneously, limits are to be introduced on where Sberbank credit resources may be allocated, those having been increased as a result of the restoration of the population's savings. Their utilization should be restricted to investment in the productive sphere, in accord with the established structural policy priorities. For this purpose,

4. In the first phase of Russia's "reforms," 1992-93, quadruple-digit annual inflation rates and the devaluation of the ruble by an order of magnitude wiped out the value of these savings deposits.

they should be restricted to investment accounts, with a ban on their sale and limitation of inter-bank credits to the provision of credits to authorized investment banks and development institutions.

Organized in this way, the restitution program for citizens' savings makes it possible to rapidly reduce real budget spending as against the paid-off state bonds, as well as to return a portion of these funds to the budget, which will be the result of the general expansion of economic activity and, consequently, the tax base. In parallel, it becomes possible to economize on budget resources, by replacing them with

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a program of housing and utilities subsidies, by the reduction of unemployment, and the increase of citizens' incomes.

The program for the restitution of citizens' savings may become a key lever for shifting to economic growth and a socially oriented market economy, as well as an instrument for the consolidation of society, which is extremely important for ensuring social stability and a transition to social partnership, which are necessary for the stable development and prosperity of society.

2.2. The expansion of state demand should be linked with the natural functions of the state (defense, social protection, education, health care), as well as with the solution of problems of economic development, not affordable for the private sector (science, transportation and telecommunications infrastructure, the power industry). Within this, it is crucial that there be a strict ban on the purchase of imported products with budget funds. State purchases should also correspond to structural and industrial policy priorities, and should have a high multiplier effect, stimulating economic growth.

The effectiveness of special measures to activate state demand and provide for the structural reorganization of the economy, depends to a decisive degree upon the correct choice of priorities.

From the standpoint of science and technology, the selected priorities should correspond to promising directions

for establishing the new technological mode and for timely preparatory work for the next one.

From an economic standpoint, state support for efforts to carry out the priority lines of work should be characterized by two most important features: 1) to have a significant radiating effect, improving the general economic environment and the conditions for developing business activity; 2) the ability to initiate the growth of business activity in a broad range of branches of industry, involved with priority types of production, i.e. to have a multiplier effect, generating a spreading impetus for the growth of demand and of business activity.

From the standpoint of production, state incentives should bring about growth of the relevant enterprises' competitiveness, such that, starting at a certain moment, they can take their own trajectory of expanded reproduction on a world market scale, playing the role of "locomotives of growth" for the economy as a whole.

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From a social standpoint, implementation of the priority directions of the economy's structural reorganization should be accompanied by an increase in employment, growth in the real wages and skill levels of the working population, and a general improvement of the people's welfare. It goes without saying, that the selection of the priority directions should take into account the preparatory work already done and the competitive advantages, which there are objective possibilities to develop.

Among the priority directions, implementation of which under appropriate state programs meets the above-indicated criteria, are the following, in particular:

- development of biotechnologies, sharply raising the efficiency of the agroindustrial complex;
- development of new microelectronic technologies, which make possible a rapid increase of the competitiveness and efficiency of domestic machine-building;
- renovation of the civil aviation fleet, whose obsoles-

cence has reached a critical level; the relevant possibilities exist for producing a new generation of airliners to replace it;

- renovation of equipment at electric power stations, where obsolescence is approaching critical limits, including modernization of nuclear power plants;
- modernization of management systems in rail transport, as well as creation of efficient management systems for mixed carriage freight;
- production of up-to-date means of flexible automation and mechanization for agriculture;
- development of up-to-date transport junctions: sea-ports, airports, railway stations, highway interchanges—these make it possible to substantially improve the speed and reliability of mixed carriage deliveries, to create conditions for the introduction of modern delivery-management systems using the "just-in-time" principle, which is critically important for developing enterprises of the new technological mode, and for expansion of interregional and international production cooperation;
- development of housing construction based on the latest technologies;
- development of information infrastructure on the basis of modern satellite and fiber-optics communications systems, and cellular phone communication in cities;
- modernization of the non-productive sphere of the economy on the basis of the most up-to-date domestically produced equipment (diagnostic devices for medicine, computer technology for the education system, and so forth);
- the active use of state purchases of the very latest equipment, to be leased in order to accelerate productive capital renovations;
- development of the space services sector, support and development of competitive advantages in the area of rocket technologies and space exploration;
- improvement of the environment through the use of modern, ecologically clean technologies.

3. Dedollarization of the economy includes measures to strengthen control over currency, which means the decisive application of existing sanctions for the violation of currency laws, as well as strict enforcement of limitations on the acquisition of foreign currency—exclusively to pay on import contracts and other legal currency operations. It is necessary to impose severe limitations on the importation of foreign currency in cash (the present influx amounts to \$1-2 billion per month), at the established norms for physical persons, as well as to ban such operations for all juridical persons except the Central Bank of Russia.

A complex of measures must be carried out to strengthen the position of the ruble on the domestic market and in international transactions. In particular, mandatory sale to the Central Bank of all foreign currency earnings by exporters should be instituted, with the gradual elimination of enterprises' foreign currency accounts. Simultaneously, it is appropriate to lift restrictions on the export of rubles, and their acquisition by

non-residents, while ensuring their convertibility for current operations. There should be incentives for the use of rubles to pay for exports from Russia, and as a reserve currency in the CIS and Eastern European countries.

Insofar as this process, in essence, will mean the replacement of one component of the total money supply (foreign currency) by another (rubles), its implementation should be supported by a ruble emission, equivalent to the volume of foreign currency collected into Central Bank reserves, plus the additional ruble demand for purposes of paying for exports from Russia and forming currency reserves in CIS countries. This emission will be non-inflationary, because it will not lead to an increase in the total volume of the money supply (its "dollar" part will merely be reduced, while the ruble part grows). For the state, this process will mean a net increase of currency reserves and an increase in revenues from their placement abroad.

The potential summary impact of the replacement of dollars by rubles, in domestic and foreign payments, as well as in foreign currency savings on the Russian market, is estimated at 250 billion new rubles. The real increase of the ruble component of the aggregate money supply, as a result of dedollarization alone, may reach at least 60 billion new rubles annually in the 1998-2000 period. This means a significant increase in monies available for investment on the domestic market, greatly expanding the potential to increase capital investments and facilitating the lowering of interest rates and resupply of money to the productive sector.

The program of dedollarization of the Russian economy should be coordinated with solving the problem of restructuring the state debt; substantial speculative foreign investments now go into servicing that debt, which exerts great potential pressure on the currency market.

Considering possible sharp fluctuations in demand for foreign currency and its supply, in the course of dedollarization of the economy, it is important to restrain these by fixing the exchange rate of the ruble for a period, while the normative levels for return on investment in circulation and production sectors are being evened out. Therefore, immediately after the transition to mandatory sale of foreign currency, and until a steep reduction in the yield on state bonds takes place, it is expedient to devalue the ruble by a factor of at least 1.5, then fix it or peg it to a basket of freely convertible currencies (above all, to the euro) for at least one year. This will make it possible, on the one hand, drastically to reduce the attractiveness of speculative operations, and, on the other, to ensure a partial restoration of the competitiveness of domestic manufacturers, which, in turn, will mean an improvement of the financial situation in the productive sector, an expansion of opportunities for the sale of domestic products, increased returns on operations in the productive sphere, approaching yields in the sphere of circulation. An additional effect of this operation will be substantial reduction of the cost of servicing the domestic state debt.

4. Incentives for effective property management. The formal transformation of property relations, as a result of mass privatization, has not been backed up by any real economic responsibility mechanisms, which would ensure that economic entities are interested in raising economic efficiency and the long-term development of enterprises. To solve this problem requires a system of measures to regulate property relations.

4.1. An inventory of the results of privatization, with cancellation of any acts that were illegal and obviously harmful

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to the country's economy, or that threaten national security interests, as well as deals in which state property was acquired, but the obligations assumed are not being fulfilled, and with a final definition of property rights with respect to the remaining enterprises.

4.2. Firm protection of legally acquired property, and a cardinal improvement in the effectiveness of the judicial system's work in this area.

4.3. Introduction of state control of land transfers through a system of land banks; speedy completion of the drafting of land legislation.

4.4. Introduction of a strict system of responsibility for the efficient management and handling of state property.

4.5. Tightening of standards for paid officials, with respect to responsibility—before shareholders, employees, and the state—for the efficient management of corporate property. There should also be legal provisions for the participation of the representatives of labor and of small shareholders in the governing bodies of joint-stock societies, especially in large privatized enterprises.

Implementation of the above-listed measures and lines of economic policy defines a way out of the depression, onto a new trajectory of economic growth, ensuring that the above-mentioned guidelines can be followed.