

Are Putin's Plans For Real?

Concluding his presentation of a \$570 billion five-year transportation infrastructure development program for Russia, Prime Minister Vladimir Putin said May 20 at the Russian Transport-2008 show in Sochi, "We worked on this program for a long time, and those were difficult discussions for essential reasons, not only technical ones. But we understand that the future of the Russian economy largely depends on its implementation, because you cannot build a modern economy without infrastructure. . . . Without developing infrastructure, there is not and will not be any economic development. . . . If we do not develop infrastructure, we have no future. And the development of infrastructure is an exceedingly important task, which falls precisely to the government. In many other sectors of industry, we can merely provide support to private business and be confident of success, but here, that is absolutely inadequate. The development of infrastructure is the direct obligation of the government."

The article we publish here, by Prof. Stanislav Menshikov, which appeared May 25 in the Moscow weekly Slovo, looks at the tension over economic policy between two wings of the new Russian cabinet, which was formed on May 12 with former President Putin as prime minister. Different policy approaches—one traditionally monetarist and the other state-interventionist—are contending within Russia, in the midst of the financial and economic crisis unfolding on a world scale. Speaking at the XII St. Petersburg Economic Forum on June 7, President Dmitri Medvedev took note of the utter failure of the existing "global financial architecture." While welcoming Medvedev's recognition that the current crisis is "systemic"—the Russian leader used this term with regard to the role of derivatives contracts in driving food and raw materials prices—EIR founder Lyndon LaRouche characterized Medvedev's proposals for "new rules of the game" as not just inadequate, but "rotten," because they would attempt merely to reform the current, disastrous system.

Professor Menshikov's report, showing that Putin's best intentions to modernize the economy are already threatened by rampaging inflation, illustrates how high the stakes are for Russia, and all Eurasia, in the matter of creating a new, development-oriented monetary system. Rachel Douglas translated the article from Russian.

Now that the new Russian government has been formed and has taken its first steps, the question might be asked with



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Prof. Stanislav Menshikov, shown here speaking at a Schiller Institute conference in Kiedrich, Germany, in September 2007, identifies the tension over economic policy within the new Russian cabinet, between neoliberals and state-interventionists.

some perplexity: Are they really going to try and implement the Putin Plan, and make a shift to an innovation economy?

As prime minister, Vladimir Putin himself now has the reins in his own hands, giving him the ability to manage the economy, whereas earlier he could only exert his influence indirectly, not through hands-on management.

Are the Neo-Liberals Too Strong?

At the same time, the composition of the government is striking. Although Putin chose its members, the make-up of the cabinet does not cohere with the announced goal. The economic section of the government remains essentially the same, with Alexei Kudrin as minister of finance and Elvira Nabiullina as minister of economics. Then there is the addition of First Deputy Prime Minister Igor Shuvalov, which only compounds the problem, since he, too, is a monetarist and a neo-liberal. These people are opposed, as a matter of principle, to active intervention in the economy, to the pursuit of an industrial policy, and to financing innovation investments out of the Stabilization Fund.¹ It would be difficult

1. Russia's over \$150 billion Stabilization Fund, formed from duties on oil and gas exports since 2004, was divided early this year into a Reserve Fund (\$125 billion) and a National Welfare Fund (\$32). While monetarist doctrine says these monies must be kept out of circulation within the Russian economy, for fear of their driving inflation, their investment is a matter of intense debate. The term "Stabilization Fund" continues to be used for this whole category of assets.



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As President, Vladimir Putin, now prime minister, projected that Russia would emerge as one of the world's top five economies by 2020. The current economic slowdown contradicts that projection, Menshikov writes. Putin is pictured here (center) at the Kurchatov research institute in Moscow, April 2007.

to imagine a worse team.

At the very first full cabinet session, on May 14, Putin criticized these ministers for the inadequacy of their proposed innovation program and for their inability to deal with inflation. That was a bad sign. Coming from these officials, such failures are caused not merely by inefficiency or incompetence. They are a kind of quiet sabotage, which reflects their covert rejection of the fundamental principles underlying the prime minister's program. These neo-liberal ministers are neither allies nor helpers for Putin, and he won't get very far with them.

The opposite tendency, that of the active *gosudarstvenniki* [officials oriented toward a strong role for the state], was previously represented in the cabinet by Sergei Ivanov. Now he has been joined by Igor Sechin, Putin's former right-hand man at the Kremlin. Sechin and Ivanov, as deputy prime ministers, are in charge of industry, while First Deputy Prime Minister Victor Zhukov oversees agriculture. Their direct role in determining macroeconomic policy, however, would appear to be relatively small in comparison with that of the neo-liberals.

This division of responsibilities is already producing its first negative effects. The Ministry of Economics has stated an average expected growth rate of 6 to 6.5% of GDP annually, whereas 7%, or even 8% annual growth was achieved in recent years. The projected slowdown contradicts Putin's long-term program, since such growth rates would not allow Russia to emerge as one of the world's top five economies by 2020. Whether or not this growth rate will be corrected, is not yet known.

Another striking piece of news came out in the press: The government will abandon the fight against inflation, handing this task entirely to the Central Bank. At first, I found this report hard to believe, since Putin has by no means suspended the fight against the explosion of prices. But then it became clear that what was meant is the abandonment of things the neo-liberals don't like, such as any anti-monopoly measures or restrictions on excessive price hikes by retailers and other middlemen. This is all the more surprising, in view of President Medvedev's having spoken in favor of such restrictions, during the electoral campaign. But it appears the neo-liberals are sticking to their line, without meeting the kind of resistance that should be there.

It may be noted that the prime minister himself, intentionally or not, aided the neo-liberals with several of his statements. During his confirmation hearings before the State Duma, Putin mentioned

only one way of fighting inflation: increased agricultural production. But our inflation has many causes, of which protecting domestic food production is only one. The inflation fight requires systematic efforts on several fronts at once.

The prime minister is correct to emphasize the urgency of boosting agriculture and reducing food import-dependence. But agriculture did not collapse in a single year, and it will take a long time to restore it. Meanwhile, double-digit inflation is an immediate problem that must be addressed without delay. By not moving to limit the actions of monopolies and middlemen, the neo-liberals are only delaying a solution.

The price increases Russia is experiencing are not solely a monetary phenomenon. Therefore the Central Bank alone will not be able to deal with them. The monetarists propose, for example, to fight inflation through an upward revaluation of the ruble, which would cheapen imports for Russian consumers. But the anti-inflationary effect of such an action will simply be wiped out with the next round of price mark-ups.

Another proposal is to increase bank lending rates, thus restricting market demand. But tightening credit will slow down the entire economy, contradicting one of the main objectives of Putin's program.

Another indication of the government's priorities is the recently announced steep hike in rates charged by the natural monopolies [natural gas, electric power, and railways—ed.], which are scheduled over the next three years. This decision was taken by the Zubkov cabinet at its final session, with Putin expressing complete agreement with it, and issuing a special statement to refute criticism of this step. He was not at all bothered by the fact that an effective doubling of the cost of



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While President Dmitri Medvedev has spoken in favor of anti-monopoly measures and restrictions on excessive price hikes, it appears the neo-liberals are sticking to their line, says Menshikov, without meeting much resistance. Here, Medvedev visits the Chelyabinsk Electrometallurgical plant, January 2008.

electric power, gas and railway freight charges will make all other goods and services more expensive, driving overall inflation even higher.

Putin believes that these rate hikes are proper, since there is supposedly no other source of financing for capital investment in these industries. If the rates were not raised, in his view, such investment would have to be financed out of the federal budget, at the cost of reductions in spending on social programs.

Such arguments would be fair, if the natural monopolies were operating at a loss, having neither profit nor depreciation allowances from which to form their own sources of financing. According to the corporate reports of [the national electricity utility] United Energy Systems (UES), Gazprom, and Russian Railways, however, such internal sources of financing do exist. There are also such potential sources as the Stabilization Fund.

Whether or not such resources would be sufficient is another question, but in answering it, certain other factors ought to be considered, such as the spending these companies do outside of their main areas of operation—for things like acquiring mass media outlets, paying outsized bonuses to their executives, and other administrative extravagance. Substantial resources could be found here by economizing.

It would appear that the prime minister underestimates both the true size of the investment sources that exist, and the real danger of inflation. Evidently he is using official statistics, which seriously understate the price rises that have occurred. The more thorough calculations, done by the Statistics Institute on the basis of the household budgets of tens of

thousands of families, show that the cost of living rose by around 30% in 2007, rather than the 12% claimed by the Federal Statistics Service. This means that a significant segment of the population continues to live in abject poverty. Comparison of the prices for food staples in Russia and in Western Europe reveals that prices in Moscow are currently double the West European levels, and 2.5 to 3 times greater than U.S. prices, while most of our population has incomes that are only a fraction of the household incomes in those countries. A few more years of refusing to combat inflation, and the government will confront a rising level of public protests.

One more danger, from an unexpected quarter, is that the comparison of Russia's GDP with that of other countries is based on the relative purchasing power (RPC) of the ruble and other currencies. Our rate of inflation is already diminishing the RPC of the ruble. If this continues, there

is no way Russia will be among the world's top five economies in 2020.

The Industrial Policy Is Alive!

It may well be, however, that what we are seeing here is a tactical maneuver by the *gosudarstvenniki*, who are regrouping for an offensive in the most important area: implementation of the industrial policy, announced earlier, and a shift of the economy into an innovation-based phase of development.

The prime minister's own activity points in this direction. Putin is not sitting in the Moscow White House [government headquarters—ed.] and governing from there, but has gone on the road to visit major economic facilities. During these tours, he is drawing public attention to the most important components of his long-term program.

Alongside agriculture, transportation infrastructure quickly took center stage. Visiting new port facilities that are under construction on the Gulf of Finland, Putin emphasized the importance for Russia of the Baltic pipelines system. Even more important, and fundamentally new, was the highway, railroad, and airport expansion program announced in Sochi [May 20]. This five-year program is to receive 13 trillion rubles of financing [see *EIR*, May 30, "New Russian Leaders Turn to Economic Security, Eurasia"], of which 4.7 trillion rubles will come from the federal budget. In dollar terms, this \$570 billion program is the largest in Russia's modern history.

The story behind the transport project is quite telling. It began to be developed a year and a half ago, but its adoption

was constantly postponed, due to objections from several government ministries. It was unveiled at the Sochi transportation event over the objections of Finance Minister Kudrin. At the beginning of the session, there was an unusual incident. Deputy Prime Minister Sergei Ivanov, who was chairing the meeting, proposed that everyone opposed to the program leave the room, thus making it clear that he was not prepared to tolerate further objections. Only then did he turn the microphone over to Putin to make his report.

That incident could set the tone for deliberations within the new government. The neo-liberals will have their say, but only if the prime minister permits it. Under such a system, the neo-liberals' position in the cabinet may be significantly weakened.

Nonetheless, although the infrastructure project was adopted in Sochi and approved by Putin, much about it remains unclear. First of all, the relative shares of highway and other infrastructure construction were not spelled out. That opens the gateway to rivalry among various agencies, which will inevitably delay implementation of the project.

There are various opinions about who will oversee these construction projects. Minister of Transport Igor Levitin quite correctly believes that specialized state companies should be created, since the private sector has no road-building capability ready to swing into operation. The neo-liberals, naturally, believe that all construction contracts should go to private companies. There are intense battles ahead on this account, as well.

Financing for the transport program remains murky. The 4.7 trillion rubles that are to be earmarked from the federal budget, constituting a little more than one-third of the 13 trillion ruble total, appear to be solid. All the rest, almost two-thirds, of the investments will have to be raised from private sources. It is proposed to issue government-backed transportation bonds for this purpose at fairly high rates, like 9% per annum.

Will there be an adequate influx of investments from the private sector? There are grounds to doubt that. As a rule, investing in infrastructure is not a high-yield proposition. Nor is it clear what the government's source of money for paying interest on the new bonds will be. Most likely these payments will become a new burden on the budget. There was some discussion in Sochi of investing a portion of long-term pension fund resources in these bonds. It is hard to avoid the impression that at a certain point, the project will encounter an acute shortage of financing.

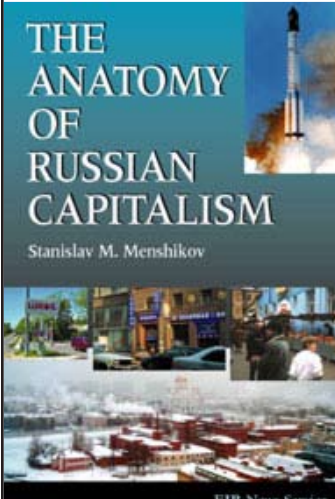
A number of other difficulties and obstacles can be anticipated. Still, an important first step has been taken at the very outset of the new government's work. It will be good if the bold, energetic style that can break through the bureaucratic morass becomes the hallmark of Putin's work as prime minister.

Another positive sign that the long-awaited Superjet-

100, a regional airliner developed by the Sukhoi Design and Test Bureau under the state-owned United Aircraft Corporation (OAK), made its first flight in May. The development of this new aircraft took several years, and has been seen as a turning point in the revival of the Russian civilian aircraft industry. The delays were connected with insufficient financing. The establishment of OAK [in 2006] sped things up. Within a few months, mass production will start, and there are customers lined up to place orders. This is a first for the post-Soviet period.

In Sochi, Putin expressed his pleasure over the Superjet's success. His plans include boosting the Russian civilian aircraft industry to third place in the world. Initially, the target date for accomplishing this was 2015, but it has been set back to the mid-2020s. Nonetheless, the objective remains of creating an entire new aircraft fleet. Sergei Ivanov is in charge of the industry.

Another of the new deputy prime ministers, Igor Sechin, is handling shipbuilding, in addition to some defense sectors. Another unified state corporation is to be created for shipbuilding, but the organizational preparations have not been completed. Sechin is known as a talented administrator, though he has not yet proved himself as an economic manager. The subjective factor is just as important for economic leadership, as in politics.



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What About Innovation?

While progress in the industrial policy is visible, there is not yet much motion in the direction of an innovation-based economy. Great expectations are connected with the person of Sergei Chemezov, who has become head of a state-owned corporation called Russian Technologies. A substantial portion of Russia's machine-building capacity is concentrated in this organization, leading to hopes that it might become the driving force for a powerful technological surge.

Chemezov, however, unexpectedly put forward the idea of establishing a state-owned mining and metallurgical concern. The logic behind this proposal is puzzling, to say the least. The Russian steel industry is well-developed and there is sufficient private capital engaged in it, to make supplementary state investment a matter of no special urgency. The same cannot be said for machine-tool production, where private capital is less eager to invest.

Furthermore, the steel industry is not the main sector for the development of new technologies at the present time. It would seem that Chemezov's project might deflect attention from the most important areas for technological innovation.

To date, it is almost exclusively the government and the state-owned corporations that are doing anything about innovation, while the private sector is less interested in developing and producing new technologies and new, improved, and high-quality types of products.

When Russian private companies need new machines, they prefer to buy them elsewhere, preferably abroad, than to produce them themselves. That is understandable, since the development and production of new equipment and technologies requires special R&D departments, which most of our private firms lack. This is why our industry has a systemic problem of technological backwardness. The lag can be overcome, only if we establish our own capacity to generate and produce innovative technologies. There is no other pathway than for companies to set up their own design bureaus, testing facilities, experimental plants, and other institutions for the development of science and technology.

This would be something entirely new for them, and very expensive. The private sector will not do it without special tax incentives. Merely an overall relaxation of the tax regime, such as lowering the value-added tax, will not help, if it is not linked to making investments in new technology. There are not yet any indications that the government is prepared to adopt special tax breaks, expressly designed to promote technological progress.

But it makes no sense to wait for favors from neo-liberal Minister of Finance Kudrin in this area. Prime Minister Putin will need to take the initiative here. With regard to technological advance, as well as other in areas of the economy, there will be no motion without his decisive intervention.