

Modernizing the Russian Economy



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The wildfires and heat wave that ravaged Central Russia last year brought Russia's super centralized political and fiscal system to the forefront of the country's domestic agenda. The severe impact of the fires which caused more than fifty deaths and destroyed more than one third of Russia's wheat crop offers an opportunity for the country's leaders to rethink its priorities and devote urgent attention to becoming a global leader as Russia modernizes its economy. An anonymous blogger from the rural Tver region northwest of Moscow has captured the mood of many Russians when stating, "Under the communists...we had three fire ponds, there was a bell people rang if a fire started and...a fire engine-one between three villagers, its true, but there was one". Today, the ponds and the fire engine are gone and the bell has been replaced by a telephone that has not been connected. The sentiment echoed by the blogger reflects the growing public anger at the authorities' struggle to slow the spread of these wildfires which have destroyed thousands of homes and destroyed acres of forest. The super-centralized political and fiscal system traditionally enacted by Russia's leadership has meant that resources meant to tackle the crisis have reached the regions too slowly and that communication was lacking or non-existent.

As life in Moscow has begun to return to normal, the wildfires have created a unique opportunity for Russia's leaders to advance its newly proclaimed commitment to economic privatization and energy efficiency. Indeed, according to Nikolay Petrov, a political analyst at the Carnegie Moscow Center think-tank, "The fact that the death toll is much higher than in other countries where such fires occur...shows the system of management is absolutely dysfunctional."

The goal of increased privatization in Russia is based on the promotion of policies that are designed to achieve market based systems that improve social welfare and lead to integration into the world economy.

Privatization initially occurred under Mikhail Gorbachev with the establishment of private/co-operative commercial banks and the creation of a domestic securities and commodities exchange. Farmers were encouraged to lease land for agricultural production outside of the collective farm system and businesses were encouraged to trade directly with foreign companies, thereby ending the state's historical monopoly. However, production remained closely tied to the state and when confronted with political pressures dealing with the scope and extent of private property, Mikhail Gorbachev balked and caved in to the proponents of traditional central planning.

Under Boris Yeltsin, free market reformers such as Yegor Gaidor, Boris Fedorov and Anatoly Chubais wielded significant power and led the effort to reduce government

spending, restrain growth in the money supply and stabilize the ruble. However, the effectiveness of these measures was undermined because of strong resistance by influential command economy politicians in the Russian Parliament as well as a major disagreement with the Central Bank over the level of spending.

Once Putin and then Dmitry Medvedev came to power in Russia, the commitment to strong privatization of state owned industries has been a major priority. Medvedev recognized that building a strong and flexible economic base is crucial for Russia to be competitive with China and the United States in the global economic arena. Medvedev must make a commitment to withdrawing subsidies on various industries to ensure free and fair trade, discourage the growth of monopolies and encourage price competition. Taxes should be transparent and less burdensome to small businesses in Russia, especially when they come to the USA seeking foreign partners. Barriers to imports and foreign investment must be eliminated. Finally, when converting state owned enterprises to private sector companies, there must be strong emphasis placed on corporate management and directors to be accountable to their shareholders by increasing the percentage ownership of foreign shareholders in these privatized companies.

In China, this model of converting state owned enterprises into private companies, seeking a joint venture with a foreign partner, has been relatively successful. It has required the Chinese corporate officers to allow the foreign partner to have a greater percentage of ownership (up to 49%) in an effort to grow the company, ensure profitability and create an understanding among the Chinese about how to become better capitalists in a global market. The creation of Russia's new Silicon Valley clone is an effort on Medvedev's part to stimulate and encourage growth of privatization and create opportunities for Russian entrepreneurs to partner with foreign corporations in this economic development zone.

A major impediment to privatization and entrepreneurship in Russia is a public perception that these concepts are linked to industrial corruption, economic inequality and enhanced criminal activity. In order to create an economic and regulatory framework/environment that promote and encourages private sector growth, Medvedev must exert strong personal and political leadership throughout the whole process. Fairness and transparency should influence public perception in Russia that privatization will create jobs and economic opportunities for the working public.

Continuing to strengthen the rule of law, with the assistance of multi-national law firms which are well-established in Russia, will aid Medvedev in his endeavors to bring foreign investment into the country. By shifting more of Russia's economy into the hands of small business, opportunities for corruption that occur when economic power is concentrated into the hands of a few oligarchs could be greatly reduced.

A successful model of privatization in Russia has been achieved through the de-regulation of Russia's largest state owned department store, GUM. According to a report issued by the CATO Institute, with over 18,000 shareholders, half of GUM's major

co-owners are foreign investors and profits grew to R40 billion from 1993-1994.

Some of the most innovative efforts at privatization in Russia have taken place at the municipal level involving the World Bank program in Nizhy Novgorod. This program mandated the forced sale of assets of companies undergoing privatization and occurred through the deregulation of trucking, where state trucking co-operatives were each required to sell roughly twenty percent of their fleet in an open auction. The resulting effect of this program produced a group of private truck owners capable of competing with established enterprises.

Since agriculture was one of four industries being privatized by the Kremlin in an effort to overturn the negative effects of Stalin's forced collectivization, Nizhy Novgorod also experimented with agricultural reform. This program involved the dismantling of collective farms and occupants were issued title certificates which permitted them to acquire both land and equipment in auction. Preference was given to current occupants, valuation of the land and equipment was transparent and decisions on how to organize production was left to the bidders in auction. This was designed to ensure Russia would be one of the only countries in the world with the potential to sharply increase grain production.

This program has not been applied on a national basis as it has tended to run counter to other government programs involving large subsidies and a continued leading role for collectives and co-operative farms in the agricultural sector. Consequently, critics of privatization in Russia were quick to point out the failure of Nizhy Novgorod during the wildfires because a new Forest Code enacted in 2006 dismantled an agricultural and federal forest safety system, thereby transferring governance and responsibility to regional authorities. The farmers and forest tenants, such as privatized logging companies, failed to live up to their obligations as stewards of the land and performed badly.

In Russia, the continuing development of privatization must be part of an overall reform package involving continued de-regulation, progressive taxation and a strong and viable monetary policy. Like the USA, Russia must control its deficit to ensure stabilization of prices and competitive exchange rates. Elimination of subsidies, the reduction of onerous and burdensome taxes and the fair and aggressive collection of taxes due are necessary prerequisites for the flourishing of a self-sustaining private sector in Russia.

While coordinating reform measures has taken time to achieve a measured degree of success in Russia, Medvedev can only look to its neighbor and competitor, China, which has successfully integrated and implemented a free market economic system within its communist hierarchical structure. This system has achieved a level of peace and prosperity, stability and engendered strong support for the Chinese government which was lacking as recently as twenty years ago and led to massive demonstrations.

Medvedev recognizes that a well-conceived economic program, designed to create an independent, broad based and self-sustaining private sector will improve Russia's

position and image as a global superpower. The improvement in the quality of life for the average Russian is also an essential benefit, both economically, politically and socially for the Russian Federation.

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