

Russia 2010: Russian Transformations in the Context of World Development

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Introduction: The Second Coming of Capitalism to Russia

A quarter century has passed since the start of Gorbachev's *perestroika*. It is high time to strike a balance, may it be merely preliminary. Immediately the question arises: A balance of what? Gorbachev's reformation was forcibly cut short almost two decades ago, in late 1991. Its balance was made by Mikhail Sergeevich himself in his last address to the country on December 25, 1991. There is hardly anything to add to what has been said then.

The initiators of the present project proceeded from the idea *perestroika* was not only a brilliant and tragic final of the soviet period in national history. It was also a beginning of the contemporary stage in our country's life. The stage of deep, fundamental shifts intended to lay the foundations of Russia's development as a free, democratic, prosperous country.

It goes without saying that this change in the development paradigm, unparalleled in the thousand-year long Russian history, needs decades, not years, of creative and hard labor of two or three generations. As a conditional horizon we have taken the period of forty to fifty years and presume we find ourselves somewhere in the middle of period of transformations. It is high time to look around and attempt to realize where we are and why, what kind of adjustments may and should be introduced into the movement trajectory drawn.

In this work we shall try to evaluate the path followed by the country under the guidance of M.Gorbachev, B.Yeltsin, V.Putin, D.Medvedev. The personalities are different, different are the political courses, but, in the end, they have brought us to what we are having today. In a short period by historical standards Russia has made a stupendous somersault and shifted from one social system to another, opposite in its outward appearance. The country has altered everything possible - property relations, her economic structure, political system, ideological tools, foreign policy orientation. She has shrunk painfully in her size and potential and lost her toiled out status of superpower. Nevertheless, she has conserved her identity, retained the undoubted continuity in her attitude towards historical predecessors, soviet and tsarist Russia. With all the good and the bad this legacy offers.

In an attempt to put together in a single phrase the phenomenal transformation suffered by our country over the last decades we can say Russia has passed from socialism to capitalism. The statement as such does not, certainly, help us proceed in conceiving and adequately evaluating everything that has taken place. Socialism may be different, suffice it to compare Hungary in the time of János Kádár and Pol Pot's Cambodia. Capitalism displays a dispersion of none the less opportunities, take any Scandinavian country and, say, Paraguay.

Notwithstanding, this simplistic assertion captures the very essence of changes in place. It, certainly, conceals historic junctions, a bitter struggle and moments of choice, the multiplicity of realized and unrealized opportunities and projects. In this boiling pot the opportunity corridor for Russian society over the historic perspective was worked out.

Let us illustrate our idea by an example from our recent past. After gaining power M.Gorbachev did not at all intend to build capitalism in the Soviet Union. He wished to transform state socialism into democratic socialism with various forms of property and market mechanisms

employed, attach a human face to socialism; however, progress in this direction was halted first by the August putsch and then by the Belovezh collusion. Here we shall put aside the question of whether the goal of building ‘a society of democratic socialism’ is, on the whole, feasible since world practice has not (yet?) confirmed this hypothesis.

Beginning with 1988 M.Gorbachev **objectively** moved towards capitalism because his democratic novations disrupted the soviet system from within. If he hadn’t been forcedly removed from power as a result of a coup d’état, sooner or later the USSR would have taken final leave of state socialism, it would have been replaced by capitalism - not **oligarchic** of Yeltsin’s type but **democratic** of West European pattern. In this case we would have, of course, been miles away from West Europe, but at least the progress vector would have been set right.

The thing is that at the beginning of the last century Russia abandoned one capitalist system and returns now to another one, hardly similar to its historic foregoer. The 20th century was a severe examiner for all forms of world order, capitalist orders included. World capitalism, in its reckless struggle for survival, courageously borrowed everything valuable from state socialism, its historic antagonist. It borrowed so much that the definition of most developed countries in the world as capitalist lost the point for many researchers. The issue can and must be discussed, but it is important not to overlook the fact that the notion of ‘capitalism’ is quite applicable to and it works in many other states of our planet, post-soviet Russia included.

Like in the first months and years of a man’s life, the period of making of a new regime is particularly important for society, it shapes its creative potential and objective possibilities for long. This happened always and everywhere, for the modern world it is twice true. After returning to the capitalist development path Russia finds herself not in a low-density environment but in a close and rigidly built global system of relationships and interactions with a nowhere near a vantage part assigned to her. From now on she has to prove her right and ability to achieve something better than simple vegetation on the periphery of this system. Specific formation and development of bourgeois relationships in our country, their unique genetic code, the inherited and acquired design of relations with the external world, the ability to learn to play and win following the rules set not by us – many factors may seriously help or complicate the solution of the task.

For the newcomers of the world capitalist system it is highly important to what extent they blend easily and organically in with the general context of bourgeois civilization. Seen from this angle, the fate of Russian capitalism turned out to be very nontrivial. Every capitalism is, probably, nontrivial as it is deeply entrenched in national history, culture, traditions, mentality. But this general assertion is squared, even cubed if applied to Russian capitalism. Like many other things of Russian origin, it literally breaks the general line.

We can detach a series of peculiar characteristics of Russian capitalism shaping its unique image. First, it is **late** capitalism. Late not only in its second edition in late 20th century, but also in its initial, 19th-century version. As known, in West Europe capitalist relationships originated several centuries earlier, they were polished and refined from generation to generation. The heavily belated Russian relative had not sufficient historic time (yet) at its disposal to substantially progress on the way of bourgeois development, and accumulate the necessary experience of social interactions in a new environment, which has little in common with traditional national realities.

Second, it is **peripheral** capitalism. Peripheral compared to the vitally important centers of the system as a whole. It was peripheral in its previous life at the turn of the 19th and 20th century,

which is not surprising since at that time the area of capitalist development was relatively small and limited mainly to the Atlantic region. It remained peripheral also at the turn of the 20th and 21st century, which is not so natural since in the modern world not one but as many as three socioeconomic development centers exist, all of them in Russia's neighboring regions: North America, West Europe, East Asia.

Hence, Russian peripheral nature differs, for example, from the Latin American. It is not so much of geographical but rather of historic and cultural, political and socioeconomic character. The vegetable soil, the subsoil of bourgeois civilization in Russia is significantly thinner and poorer than in countries of the first and second echelon of capitalist development; and it produces strange, sometimes inedible fruits.

The young Russian capital, inexperienced and coarse, with a dubious reputation, has some trouble in finding its bearings on the vast of the world. Due to its objective and subjective parameters modern Russia experiences difficulties in fitting into one of the world development centers. Meanwhile, attempts to set up its own center on the basis of post-soviet space have not been up to now crowned with success. At the same time, in contrast to China or India, Russia is not endowed with a sufficient human potential to develop more or less autonomously.

Third, it is **dependent** capitalism. First of all economic dependence is meant, but the situation is not confined to it alone. De-sovereignization in economic matters is unavoidably projected on all spheres of public existence. For a country accustomed to have a mind of her own this condition is unusual and uncomfortable.

The narrow horizons and possibilities of national capital are conditioned by many factors and circumstances. The late genesis of Russian capitalism, forced hibernation on the edge of world development impose substantial restraints on its independence both in the past and present-day life. The situation was exacerbated by strategic miscalculations of post-soviet Russia's godfathers. Obvious disregard for building modern state institutes, failure and reluctance to design a thought-through strategy of the country's modernization, a blind faith in the almightiness of the market, unbounded and indecent preoccupation with their own affairs and sharp dealings did not allow to break off the chains of dependence and enter an autonomous orbit.

Of course, in this respect the first decade of the present century differs radically from the last decade of the previous century when Russia actually turned into a country with limited sovereignty, her economic activities included. After 2000 the country regains her political subjectivity. She disengages herself rather rapidly from the restraints of financial dependence on Western capital. Her foreign policy is primarily aimed at protecting national interests. Modernization issues become part and parcel of the political discourse.

But modern Russian capitalism is still too weak and inexperienced to be able to take part on equal footing in the tough competition unfolding in the global world for the place in the sun. Whatever we consider – be it national economy, social sphere, civil society, party and political system, state institutes, values and cultural samples – post-soviet Russia is obviously inferior to her Western and Eastern partners-rivals. The first crisis of the global world, which particularly vigorously hit the national economy, made the organic vices of the Russian version of post-communist structure, its brahynoe, relentlessly obvious.

Fourth, it is **recurring** capitalism. In this respect post-soviet Russia is, in fact, unique and unparalleled in the modern world. She is not the only country, which has been fiddling around with socialist experiments, but nowhere have they been carried out for so long and so

consistently. And in no place have such impressive results been achieved. After all, the status of the second superpower does not grow on trees and cannot be gained off-the-cuff.

One question cannot be escaped: Is the soviet legacy a solid support or a heavy burden? The answer depends, logically, on the author's political standpoint. Historians will probably discuss the issue for very long yet. Without controversy, soviet Russia has registered considerable advances on the path of modernizing society. Beyond doubt as well, the country has paid a fantastic price for all that. In the end, she found herself in a historic deadlock and had to pay for an exit by the most valuable and expensive she had at her disposal – by people, territories, resources.

Conventional wisdom runs: normal heroes always take a round about way. Maybe it refers not only to people but also to states. But in the 20th century our country has chosen too long roundabout by half. And excessively costly. We shall feel the outcome of the flagrant waste of human capital for very long yet.

Five, it is **camouflaged** capitalism. With all its gall and brazenness it is ashamed of itself, ashamed to be capitalism. It is clear why the last CPSU general secretary did not utter a word about us taking the path of capitalist development. It would have been tantalizing for him, socialist by nature and conviction, to acknowledge it even to himself. His colleagues in the central committee would have hardly understood and approved of their party leader's new vocabulary.

But what is interesting: the leaders of the anticommunist movement, who donned the garb of 'democrats', tried not to use the term 'capitalism' either. Like reformers of the early 1990s they preferred to speak of 'the market'. Apparently, they felt that even in contrast to the bankrupt state socialism 'capitalism' sounds not very appealing to us. And its first moves after returning to the Russian soil might provoke confusion even among most passionate admirers of the new order.

In general, capitalism is ideologically not very attractive. Valid ideals may hardly be designed proceeding from profit-seeking, individual enrichment, money power. The majority of people feel by intuition all this is not meant for them. Therefore, the great bourgeois revolutions of the past, for instance, the American or French, inscribed totally different characters addressed to all and everybody on their banners. That is why the making of the bourgeois system in West Europe and North America took place under the strongest impact of other systems of values taken from the richest heritage of the European civilization. That is why most successful samples of capitalism were concerned in advance with ensuring a strong ideological design, which sublimated and civilized private-ownership instincts.

The young Russian capitalism is totally deprived of this ideological and value charge. It is not pervaded by the thrust of democratic liberation as it is the case in Central and East European countries. It is not blended with national-state ideas as in other post-soviet states. An attractive package is not available: neither 'equal opportunities', nor 'socially-oriented state' and 'general welfare society', all this is not and cannot be in place. Too scaring would have been the contrast with reality.

Russian capitalism is searching for 'a national idea' with an art worthy of a better cause and is unable to find it anyhow. It faced naked the jury of society and its bareness is far from beautiful. You cannot tell the people all their sufferings and sacrifices were needed to provide for the particularly distinguished dwellers of Rublevka a heavenly life on Earth.

True, one cannot say Russian capitalism in its present-day implementation is totally deprived of typical features. Legal nihilism and moral permissiveness became its brands. The capital, 'liberated' from legal and moral norms, creates a medium for corruption and criminal activities.

You have to add to everything above 'a cold civil war' flared up between opposing political camps in the final period of communist power, and the trauma of demolishing Russian statehood - thus, the conclusion is forced upon you capitalism has returned home ill-starred.

Summing up, one can say: national capitalism is genetically flawed and needs thorough preventive measures to be taken. Its inborn vices require attention, treatment, qualified help rendered by society and the state.

Nevertheless, its coming is regular and justified. Our country has literally pained the chance to proceed on the development path broken off in 1917 by the Bolshevik take-over. Painful as it may be to recognize, one has to assert that Russia has lost the 20th century. She did not progress over the past century but, rather, rolled back by the main indicators of world ranking: territory, population, comparable level of economic, social, political development, international prestige. Perhaps the same may be applied to other big European powers, such as Great Britain, France, Germany, but it's no comfort. In any case their situation today is by far better than ours.

What has the incoming 21st century in store for us? The reversion to the fold of bourgeois civilization did not and could not bring about a miraculous effect. Illusions of post-*perestroika* in this respect vanished into smoke. There was no escape of the sword of Damocles - Russia's catching-up development. Over two recent decades we augmented, not reduced the distance between us and the most developed countries of the world.

It has perhaps found its most illustrative reflection in the economy. We reached the 1990 indicators in production output only in 2007. Due to the damage inflicted by the economic crisis we shall be able to surpass this level not earlier than in 2011-2012. Meanwhile, the structure of our national economy turned to be more primitive and backward than in the late soviet period.

The hard process of transformations going on over two decades implies that our compatriots' average standard of living is today by no means higher than at the end of the soviet period. Most likely lower if we consider the advanced social differentiation of Russian society, quite comparable with the worst Latin American samples. The phenomenal enrichment of few people is repaid by pauperization of vast layers of the population.

Apparently, by basic social and cultural development indicators we also rolled back. In healthcare, education, social welfare, overall level of culture we do not reach the standards of the late post-soviet period. In the last two decades we were outstripped by dozens of states in average life span as an aggregate indicator. The male mortality rate in our country turned into national infamy.

Although the push for democratization of public and political life was one of the main driving forces of *perestroika* processes, we were not very successful in building democratic institutes. The executive obviously dominates two other branches of government; the media, notably electronic, are lead in a string; highly problematic is the chance that opposition may come to power on the basis of public expression of will.

After beating swords into plough-shares and turning our face to the external world we feel even more lonely than before. We have few enemies but almost no reliable friends and allies.

The list of peccancies of restored Russian capitalism may be extended. And many claims against it are funded and justified. But what is interesting: the opinion polls show the great majority of our compatriots do not wish at all a return to the soviet past.

This cannot be explained by the impact of official propaganda, the more so that today the attitude of the authorities to the soviet period of our history is much more respectful than in Yeltsin time. This cannot be written off to the aberration of mass consciousness since our people with all its credulity cannot be fooled for so long. It means in post-soviet reality many pluses are to be noticed, which, in one way or another, compensate the hardships, losses and costs of the transition period.

First of all, the attitude to post-soviet reality is supported by the feeling widespread in society: it is senseless to look for answers to eternal Russian problems in the past, we should rather move forward. Russian citizens delivered their judgement to the communist order in the process of *perestroika* yet, since then it is non-appealable.

In addition, the shifts that have taken place are far from unambiguous, along with big losses there are serious gains. The most significant accomplishment in post-soviet period seems to be freedom of private life, the opportunity in principle to determine one's own fate without somebody's indication from above. In Russia it was always in great demand, in soviet time it was totally effaced.

In present-day Russian socium a tacit but endurable concert reigns: citizens and authorities lead separate lives and reduce their interaction to a necessary minimum. Clear, on this basis you'll never get anywhere, but there is reason in it as half-way away from totalitarianism.

Unfortunately, we did not yet succeed in progressing towards normally operating democratic institutes. There are plenty of reasons to it: the 1991 national catastrophe, which changed the ranking of priorities in public consciousness; the transformation shock linked with the shift of the public system, which brought many people on the brink of survival; the rapidly displayed incapacity of national 'democrats'; the consumer rush of the last decade, which put public affairs on the back burner; the unwillingness of main elite groupings to take part in real political (and also economic) competition.

Another not less important positive feature in post-soviet reality was the long-awaited coming of 'consumer society' to Russia. The market-and-store abundance emerging as if with a wave of a magic wand turned for the Russian public exhausted by the shortage of goods into an unfeigned overturn in everyday life, which produced a deep impact on the motivation structure, the system of values, behavior patterns – it was an unambiguous overturn, which was seemingly deeply regular but accompanied by its heavy costs.

Without questioning real accomplishments of the young Russian capitalism, we should make a good judgement of its potential in a historic perspective, in the context of goals the world development makes our country face. We live in a global world where development of cooperation goes hand in hand with tough competition for top places. The one, who unveils broad opportunities for the development of human personality and support of its active and creative spirit, wins.

From this viewpoint, the public structure of post-communist Russia requires capital, not cosmetic repair. And it should begin with overcoming the cleavage of the country, removing crying disproportions in distribution of power, property, income, opportunities in life. Not 'to strip and divide' but to coherently advance towards a more democratic, equitable, humane life

order. Otherwise the 21st century will be lost for us as well. And whether Russia will endure this as well is a big question.

Basic changes, whose initial impulse was given to by Gorbachev's *perestroika*, are still by far not completed. The overall situation in Russian society the authors of the book attempt to sort out is flexible, complex and contradictory. Many estimates and conclusions may be adjusted depending on further movement trajectory. But even if we are in the mid-course it is always useful to cast a look at the road left behind to draw conclusions for the future.

Chapter I. Economic Transformation in Russia in 1985-2008

The Economic Situation in the USSR by the Mid-1980s

Critical phenomena in the economy turned, to a significant degree, into the starting point of transformations begun in the USSR society and its socioeconomic sphere in the second half of the 1980s. Already by the middle of the decade (in part even earlier) negative trends came to be noticed in soviet economy: slowdown in growth rates of basic quantitative and particularly qualitative economic indicators, excessive development of the military-industrial complex (MIC) and its increasing load on the economy, imbalances in consumer goods production, slow introduction of the results of scientific-technical progress.

1. Slowdown in economic growth rates. For example, the average annual change of national income produced in the USSR decreased constantly according to national statistics: from 5.7 percent in 1971-1975 to 4.3 percent in 1976-1980 and 3.2 percent in 1981-1985. The change rate lowered also for other indicators.¹ But at first sight even lower growth rates proper of several macroeconomic indicators did not evidence any serious crisis in the country's national economy.

2. At the same time qualitative indicators of economic development deteriorated as well. Growth of national income produced per material production worker decelerated.²

Another qualitative indicator testifying a steady deterioration was capital productivity. In 1981-1985 it sank by 3.3 percent a year.³ This is only one among the far from perfect indicators showing lowering efficiency of planned economy operation. It reflected the fall of investment efficiency due to its diffusion among economic sectors and its longer pay-back period.

3. Distortions in the economic structure in form of raised fabrication of means of production compared with that of consumer goods became one of the key economic problems: in 1980 the share of the former in gross industrial production made 73.8 percent whereas the latter was 26.2 percent, respectively. By 1985 the situation even worsened to some extent: the proportion was already 74.8:25.2.⁴ As a result, the problem of consumer goods shortage emerged. Since market as a mechanism of identifying consumers' preferences was lacking (though in some spheres market or quasi-market relations did exist) to overcome the imbalances established was a difficult task. Meanwhile serious economic disproportions in form of an expanding income of

¹ The gross industrial output rate fell from 7.4 percent in the first half of the 1970s to 4.4 percent in the second half of the decade and 3.6 percent in the first half of the 1980s. Growth of capital investment into national economy, of retail turnover and other indicators also decelerated. In the first half of the 1980s the lowest growth rates were registered in industries like the fuel sector (particularly oil development where production sank by 0.4 percent annually), oil refining and light industry. See *Statisticheskiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi*, 1990. M., *Finansy i statistika*, 1990. S.14 [*Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.14*].

² Over the period of the 1980s this indicator grew by 2.7 percent annually against 4.5 percent in the first half of the 1970s and 3.3 percent annually in the second half of the 1970s. See *Statisticheskiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi*, 1990. M., *Finansy i statistika*, 1990. S.14 [*Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.14*].

³ *Narodnoe khozyaistvo SSSR v 1990 g. M., Finansy i statistika*, 1991. S. 321 [*USSR National Economy in 1990. Moscow, Finansy i statistika Publishing House, 1990. P.321*].

⁴ *Statisticheskiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi*, 1990. M., *Finansy i statistika*, 1990. S.164 [*Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.164*].

the population not adequately provided for by related consumer demand for products made was gradually accumulating.

Another significant structural distortion was excessive development of MIC with the best resources allocated in the area. Resource restraints here were much weaker than in the civil sector, and the spread of MIC, among other things caused by arms race, created a considerable load on the economy. At the same time the efficiency of resource utilization in civil sectors of the economy was falling.⁵

One of the manifestations of the negative situation in economic structure was the USSR foreign trade structure, notably, its export structure whose fundament were raw materials and primary processed products. By 1980 57.2 percent of USSR export made fuel, mineral raws and metals, 15.8 percent machinery, equipment and transport vehicles; in 1985 these indicators made already 61 percent and 13.9 percent, respectively.⁶ In addition it should be born in mind that by the end of the first half of the 1980s world energy prices started to gradually fall.⁷ Consequently, by the mid-1980s export from the USSR began to shrink against a steady growth of import up to 1985,⁸ - thus, the foreign trade balance deteriorated.

4. The economy displayed a weak responsiveness to scientific-technical progress, therefore the problem of balancing extensive and intensive economic growth factors was raised. According to data presented by A.I. Anchishkin, the share of extensive factors amounted to more than 80 percent in USSR national income growth and made 100 percent in gross agricultural production growth.⁹ Investment was mainly aimed at supporting existing production facilities, not developing new ones and modernizing production.

Accumulated economic problems cannot be explained exclusively by insufficiently thought-through planning or somebody's 'ill will'. In soviet planned economy systemic flaws were obvious. In many respects they were linked with economic agents' motivation system. On the one hand, in the sphere of production individual enterprises were known to be oriented not at the consumer but at planning institutions. At the same time their relationships proceeded also from differing interests of both parties: the higher body was interested in allocating minimal resources and giving a maximally high production assignment whereas the producers in getting a maximal amount of resources and a minimally low planned assignment. A situation of peculiar 'information asymmetry' emerged: enterprises had broader information at their disposal but resources were concentrated at the level of the authorities,¹⁰ which gave rise to phenomena of so

⁵ Yaremenko Y.V. Ekonomicheskie besedy / Tsentri issledovaniy i statistiki nauki. M., 1998. S.38-44 [Yaremenko Y.V. *Economic Conversations / Center for Research and Statistics of Science. Moscow, 1998. P.38-44*].

⁶ Statisticheskiiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi, 1990. M., Finansy i statistika, 1990. S.573 [Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.573].

⁷ For example, in 1983 the average Brent crude price per year was \$29.83 a barrel, by 1985 it sank to \$27.33 a barrel. See International Financial Statistics.1996. Yearbook. Washington DC: IMF, 1996. P.165.

⁸ Statisticheskiiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi, 1985. M., Finansy i statistika, 1985. S.327 [Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1985. Moscow, Finansy i statistika Publishing House, 1985. P.327]; Statisticheskiiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi, 1990. M., Finansy i statistika, 1990. S.567 [Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.567].

⁹ Anchishkin A.I. Vybor strategii. Iz neopublikovannogo naslediya / Tsentri issledovaniy i statistiki nauki. M., 2003. S.13 [Anchishkin A.I. *The Strategy Choice. From Unpublished Legacy / Center for Research and Statistics of Science. Moscow, 2003. P.13*].

¹⁰ Nekipelov A.D. Yest li svet v kontse tunnelya? // Drama obnovleniya/ Pod red. M.I. Melkumyana. M.: Progress, 1990. S.601 [Nekipelov A.D. *Is There Light at the End of the Tunnel? // The Renewal Drama / Ed. by M.I.Melkumyan. Moscow, Progress Publishing House, 1990. P.601*].

called administrative deal. In the final phase of the administrative command economy the influence of economic 'super-authorities' on decision-making increased greatly.

On the other hand, consumers could dispose rather freely of the proceeds gained but faced supply-side restraints (price-setting for products acquired by them was centralized). As a result shortage of some types of products emerged and gradually became country-wide. Under conditions of the population's outstripping income growth consumer shortages produced so called forced savings: unable to purchase the desired goods the consumer increased the volume of their savings hoping for a chance to raise their consumption level in the future. Alternative costs of these savings under the system of regulated prices and lacking alternative financial tools (as known, the principal form of savings were Sberbank deposits) were not high.

Particular attention should be paid to the theoretical crisis in economic science during the last stage of soviet period. The disparity between reality and basic theoretical provisions of political economy of socialism became ever more obvious. For example, the following questions surged: Why do major disproportions exist in the economy if the law of planned development is in place? Or: Why does income-levelling take place under the law of distribution according to labour?¹¹ Notwithstanding, basic laws were not subject to any revision, only some scholastic methodological discussions were underway. In other words, a situation emerged, in which the country's economy experienced hardships but the theory existing at the moment could not adequately describe their character and contribute to finding a way out of the situation established.

Hence, by the second half of the 1980s the awareness gained ground changes into the country's national economy had to be introduced. However, at the first stage a radical change of the economic system was not on the agenda, the theoretical fundament of analyzing economic processes was not subject to any basic revision either.

Main Stages of the Country's Economic Development

Let us regard Russia's further economic development and detach its key stages.

The first stage: perestroika period (1985-1991). Accumulated economic problems entailed the proclamation, in the course of *perestroika*, of a transition from the extensive to the intensive economic development type. Two transition variants existed: by way of raising efficiency of resources available in society, and by extending economic agents' autonomy.¹² The first variant accentuated more the feasibility of raising the efficiency of the system within its framework if some of its drawbacks could be overcome. The second variant concentrated more on the imperfection of the system proper. On the initial stage of *perestroika* the main emphasis was made precisely on the first variant. The need to radically modify the existing economic system was not recognized for a long time.

The 1987 Law on State Enterprise opened a qualitatively new stage in widening economic agents' autonomy. The enterprises were switched over to an overall cost accounting system, the proceeds gained were not transferred in their totality to the state budget but, instead, shared by

¹¹ Nekipelov A.D. Yest li svet v kontse tunnelya?//Drama obnovleniya/ Pod red/ M.I. Melkumyana. M.: Progress, 1990. S.595 [Nekipelov A.D. *Is There Light at the End of the Tunnel?* // *The Renewal Drama* / Ed. by M.I.Melkumyan. Moscow, Progress Publishing House, 1990. P.601].

¹² Nekipelov A.D. Ocherki ekonomiki postkommunizma / TsISN Minnauki Rossii. M., 1996. S.271 [Nekipelov A.D. *Studies of Post-Communist Economy* / Center for Research and Statistics of Science, Ministry of Science of Russia. Moscow, 1996. P.271].

the state budget and the enterprise; besides, the rigid divide between cashless and cash money circulation was removed. Apart from attempting to set up work stimuli for economic agents under new conditions, the Law also promoted in this way a gradual move of the budgetary and monetary policies to the condition typical for market economy.¹³ Further practices showed, however, that the abolition of rigid restraints in both policies named above entailed serious negative consequences (increased budget deficit and money supply). To a considerable degree, this was the outcome of a high monopolization level in soviet economy, which differed from a classical monopoly in a market economy and might be typified best as a high level of production centralization and concentration under conditions of a planned economy, but it started to demonstrate classical features of a monopoly with market relations expanding.

The May 1988 Law on Cooperatives in the USSR was oriented at overcoming 'bottlenecks' emerging in applying the Law on State Enterprise (a rather high level of centralization was retained in practice) and was intended to revive the cooperative form of property. The citizens were granted the opportunity to start cost accounting-based production and sell their products at free market prices.

Despite the measures adopted, which aimed at higher efficiency of the economic system in the USSR, its condition went on worsening. The average annual growth rate of national income produced in 1986-1989 accounted for 2.7 percent,¹⁴ in 1990 the national income produced fell by 3.1 percent; the average annual industrial output growth dropped from 3.6 percent in 1981-1985 to 2.5 percent in 1986-1990. Qualitative economic indicators continued to deteriorate: the average annual growth rate of social labour productivity declined in the above periods from 2.7 percent to 1.5 percent, capital return in industry from 3.1 percent to 2.3 percent.¹⁵

The external factor complicating economic development of the country on the initial stage of *perestroika* was plummeting world oil prices in the second half of the 1980s.¹⁶ As a result, foreign trade turnover (in comparable prices), which in 1981-1985 grew by 3.9 percent a year, in 1986-1990 demonstrated an average growth rate of only 0.9 percent a year. However, reducing problems experienced by soviet economy exclusively to external shocks would mean their obvious simplification. We had to do with a crisis of the entire economic system exposed in its various spheres.

As before, structural disproportions, including domination of the military-industrial complex, were typical for the economy. Though in 1988 military conversion was announced, MIC's active resistance did not allow to fully launch the trend.¹⁷ The sector of consumer goods production, as before, could not meet the growing domestic demand, which entailed forced refusal from consumption (notably, durables).

¹³ Under conditions of enterprises' profit totally transferred to the state budget, cashless money circulation was balanced by definition, cashless money did not, actually, fulfill the function of money; so one cannot speak to the full of a budgetary or a monetary policy – both policies turned into derivatives of the general national economic planning system.

¹⁴ Statisticheskiy ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshi, 1990. M., *Finansy i statistika*, 1990. S.14 [*Statistical Yearbook of Countries-Members of the Council for Mutual Economic Assistance. 1990. Moscow, Finansy i statistika Publishing House, 1990. P.14*].

¹⁵ Narodnoe khozaystvo SSSR v 1990 g. M., *Finansy i statistika*, 1991. S.8, 321 [*USSR National Economy in 1990. Moscow, Finansy i statistika Publishing House, 1991. P.8, 321*].

¹⁶ The average annual price of crude oil of various types fell from \$27.3 a barrel in 1985 to \$14.7 in 1988 (later the oil price achieved again the 1990 level with \$23 a barrel). See International Financial Statistics.1996. Yearbook. Washington DC: IMF, 1996. P.165.

¹⁷ Yaremenko Y.V. *Ekonomicheskie besedy / Tsentri issledovaniy i statistiki nauki*. M., 1998. S.55 [*Yaremenko Y.V. Economic Conversations / Center for Research and Statistics of Science. Moscow, 1998. P.55*].

Over the second half of the 1980s the status of the union budget as well as that of republican budgets worsened gradually within the budgetary sphere. By this time union budget deficit was assessed at 8-9 percent GDP.

Problems related to public finances gave rise to a new form of expanded foreign economic activities – the growth of government foreign debt. The USSR as a state was treated as a reliable borrower (the same referred to enterprises borrowing against state security), which entailed growth of loans incurred also by private financial institutions. Meanwhile, problems of servicing the external debt turned more and more acute. External debt payments grew 2.5 times in 1986-1991, the core of the debt increased from \$31.4 bln in 1985 to \$67.9 bln in 1991.¹⁸

Within the monetary area the phenomenon of ‘forced savings’ spread even more resulting in a growing amount of funds on bank deposits of the population, the so called money overhang.

In the course of *perestroika* no thorough shifts in the economic system took place, nevertheless the awareness grew deeper transformations in all aspects of the economic mechanism are needed, which, for example, in the issue of property relations entailed the recognition that privatization of a part of state assets is needed. It is, however, to be noted that at that moment an adequate understanding of how the economy would react on new conditions of its operation failed. Actually, over the whole *perestroika* period, schemes adopted by the political economy of socialism went on dominating without offering any solutions to problems linked with transformations carried out and without tracing ways of their further development.

The question arises of whether alternatives to the course of economic reforms applied at that moment existed. One of the authors of the present research proposed the model of ‘state sector marketization.’¹⁹ It implied state enterprises would retain the previous property form (with their shares transferred to a special State Property Fund), their operation liberalized and a parallel private sector freely formed. The goal of the State Property Fund would consist only in maximizing the value of state assets, which would have contributed to raise the efficiency of its operation and helped the economy on the whole reduce high social costs of original accumulation of capital.

In 1991 critical phenomena in soviet economy were already sweeping. By autumn 1991 control over wholesale prices was practically lost, control over retail prices was still in force. The State Bank of the USSR was limited in its capacity to regulate money circulation since central republican banks started unilaterally a credit emission to tackle their republics’ budget deficits. The situation with the state budget grew critical, particularly in view of conflicts in this area between the union and the republican leaderships. The first examples of ‘economic wars’ between the republics came to the surface: everyone of them sought to mitigate the consequences of the upcoming crisis on its territory.²⁰ In late-1991 the USSR broke up and every republic started to practice its own economic transformation pattern. We shall further focus on economic transformation in Russia.

¹⁸ *Kheifets B.A.* Reshenie dolgovykh problem. Mirovoi opyt i rossiyskaya deistvitel'nost'. M.: IKTs “Akademkniga”, 2002. S.87, 92 [*Kheifets B.A. The Solution of Debt Problems. World Experience and Russian Reality. Moscow, IKTs “Akademkniga” Publishing House, 2002. P.87, 92*].

¹⁹ See, for example, *Nekipelov A.D.* Ocherki ekonomiki postkommunizma/TsISN Minnauki Rossii. M., 1996. S.136-138.

²⁰ *Nekipelov A.D.* Ocherki ekonomiki postkommunizma/TsISN Minnauki Rossii. M., 1996. S.272-273 [*Nekipelov A.D. Studies of Post-Communist Economy / Center for Research and Statistics of Science, Ministry of Science of Russia. Moscow, 1996. P.272-273*].

The second stage of Russia's economic development within the period in consideration is of *radical economic transformation* (1992-1998). January 1, 1992, a tipping point in Russia's economic history in the given period, is traditionally taken as the outset of this stage. From this moment on, a solid part of prices in the country's economy is known to be liberalized. The liberalization of economic activities was not limited to price liberalization, it was also extended to areas like production (final abolition of planned assignments), population's income (abolition of wage limitations), foreign economic activities (abolition of a series of foreign currency restraints) and then to the shift in property relationships (the so called mass privatization), etc.

A steep price liberalization and insufficiently consistent macroeconomic policy at the initial stage of radical transformation provoked very high inflation rates in 1992-1993. The average growth rate of consumer prices in 1992 reached 1353 percent, in 1993 896 percent. Compare: in Poland the 'shocking' year 1990 - from the point of view of price liberalization - produced consumer price growth of 586 percent, in the subsequent year the inflation rate fell to 70 percent; in Bulgaria in 1991 and 1992 the values of the indicator made 334 percent and 82 percent, respectively; in former Czechoslovakia in the year when prices were freed (1991) they rose by 59 percent.²¹

At the same time economic activity contracted steeply. Real GDP fell in 1992-1994 by 31 percent. In countries of Central and Eastern Europe considerable output reduction was also observed in the first years of transformation but, as a rule, it was less in scale, and the turn to a trajectory of sustainable economic growth began earlier than in Russia (on the average, by the mid-1990s whereas in Russia only after the 1998 crisis).

A considerable external shock for Russian economy was the break-up of the previously common national economic complex of former USSR, as its outcome new independent states started to shape their own national economies, which far from always oriented themselves at retaining former economic ties. The result of the process proved to be marked reduction of mutual trade.

To theoretically explain the combination of meaningful production drop and high inflation rates at the initial stage of transition we consider it most logical to present a description of the process in terms of aggregate supply-side shock. In favor of this approach evidences, first, the multidirectional dynamics of output and general price level; second, the hypothesis may be confirmed by a considerable change in relative prices, the effect of hysteresis (linked with a part of the workforce losing its professional characteristics), etc. The scale of the shock depended largely on the inherited economic structure. With structural disproportions bigger than in Central and Eastern Europe, the scale of the transformation shock in Russian economy should have been also bigger. This, however, did not signify it could not have been mitigated by economic policy measures.

The explanation above leads us to an important conclusion: traditional recipes of either aggregate demand stimulation to enhance output or its contraction for the sake of curbing inflation prove to be insufficient under transformation conditions, they may even aggravate the situation. The authorities applied alternatively tools intended to motivate output and repress inflation by turns, which hampered the solution of both problems and reminded rather the behaviour of a fire-fighting squad. One of the ways to overcome the shock on the aggregate supply-side might have been a thought-through industrial policy to soften the consequences of heavy changes in the economy. In Russia, however, this opportunity has not been realized.

²¹ World Economic Outlook. October 1998. Washington DC: IMF, 1998. P.189.

In accordance with a traditional view, in the period of 1992-1998, particularly on its initial stage, a tough economic policy of monetarist type was practiced. But this statement is not quite true.

First, one hardly can speak of any thought-through program of actions the reformers had at the beginning of radical transformations. More likely, they hurriedly reacted to the critical situation emerging in Russian economy by late-1991.

Second, any given 'anchors' usually applied in a tough economic (and, first and foremost, monetary) policy in countries of Central and Eastern Europe, were not ensured (theoretically it is preferable to use an anchor in form of money supply, in practice, however, anchors in form of currency exchange ratio or wage are typical).

This was due to the fact that Russia was actually unable to pursue a totally independent monetary policy since in the framework of the retained ruble zone the central banks of other former USSR republics still had the opportunity to emit cashless money. Only by mid-1992 free bank transfers between enterprises of Russia and other countries-ruble zone members ceased to exist, but Russia's definite monetary independence was gained since July 1993 when new Russian cash rubles were introduced into circulation.²²

Third, the country ran a stable and considerable state budget deficit versus GDP,²³ and the refusal to finance it by Central Bank loans took effect only since 1995 when the market of domestic government debt started to develop.

One of the most marked lines of reforms after the initial 1992 shock was privatization, whose declared goal it was to create 'a strategic owner'. Formally, privatization adopted the so called voucher form (mass privatization) evidently caused by the wish to make it look socially equitable. In practice, control over enterprises, as is known already, was concentrated in the hands of a narrow group of persons. In the end, the main group sympathizing with ongoing reforms was the layer of new owners who came into being as a result of privatization. As to those who carried out these reforms, we are not inclined to search for a certain 'conspiracy theory' in their actions, or an intention to follow a previously traced line of actions in pursuit of their own interests. First, as we have noted above, the operation regularities of an economy in transformation were very vague both before starting economic transformations and at the outset of their realization. Second, the ideologists of radical reforms held as one of the basic tasks to prevent a return to the previous economic system. Problems arising during transition were regarded as costs of this 'no-return' movement. The choice of the privatization method in Russia may be regarded in this context.

By the outcomes of privatization the population realized, naturally, its social injustice, which significantly undermined in the eyes of the people the legitimacy of the shift in ownership rights. The feeling was additionally encouraged by the rapidly growing social differentiation in society.

Meanwhile, the initial goal of raising the efficiency of enterprise management was not attained either because the majority of new owners, instead of modernizing production, attracting investment, were engaged in current consumption maximization. This came to be one of the causes of massive capital outflow from the country (read about it below), and the diffusion of

²² Nekipelov A.D. Kontseptsiya makroekonomicheskoi stabilizatsii pod uglom zreniya rossiyskogo opyta//Problemy prognozirovaniya. 1994. N4. S.36-37 [Nekipelov A.D. *The Conception of Macroeconomic Stabilization through the Prism of Russia's Experience // Problems of Forecasting. 1994. No.4. P.36-37*].

²³ According to calculations of the International Monetary Fund the deficit of the state budget against GDP made 9.4 percent in 1992 and 6.7 percent in 1993. See Rossiyskaya Federatsiya // Ekonomicheskie obzory MVF. 1994. N16. S.133 [*Russian Federation // IMF Economic Reviews. 1994. No.16. p.133*]

specific institutes of reaction to the transformation shock in form of barter and non-payments (wage non-payments included) in the economy. An environment took shape, in which economic agents could fail to comply with their liabilities without being apprehensive about any essential sanctions. The environment was supported by the government, which also set an example of non-fulfillment of its obligations. For instance, the government did not pay for fuel and electric energy supplies to 'strategic consumers.' Besides, in order to tackle budgetary problems it constantly introduced new set-off schemes, which, actually, encouraged enterprises to spread non-payments. Thus, enterprise non-payments to the budget aggravated budgetary policy problems and undermined the revenue basis of state finances.

As a result, the period of radical economic transformation was characterized by a tremendous slump of production. In 1992-1998 Russia's real GDP declined by 39.5 percent, industrial output by 50 percent, fixed capital investment by 75 percent. These critical phenomena took place against the background of high inflation rates until 1997 and after the August 1998 crisis.

In the 1990s against the background of lower production of goods that of services (including those related to wholesale and retail) grew. In industry the following sectors suffered least of all from the transformation crisis: mining and quarrying of energy producing materials (the 1995 downturn in the sector made 22.2 percent against 1991), manufacture of coke and refined petroleum products (downturn of 37.8 percent), basic metals (42.4 percent) whereas over five years, from 1991 to 1995, manufacture of food products shrank by 50 percent, machinery and equipment by 61.9 percent, textile and textile products by 78 percent.²⁴ The lack of an active industrial policy stood in the list of causes for these changes in the economic structure.

If we make a preliminary balance of economic transformation as of 1998, we might state the problems the soviet economy faced exacerbated several times by the moment. Decelerated economic growth rates gave way to a plunge in production. After some initial rise in the income of the population a steep reduction was registered in the 1990s accompanied by a considerable income polarization. Structural distortions of the time of soviet economy were conserved in form of a strengthening role of mining industry, whereas machine-building was heavily hit by the transformation crisis. The share of services increased but, judging by general economic dynamics, we cannot unequivocally assert the trend promoted higher efficiency of the economy. In response to the attempts to shape a market environment the economy began to react by phenomena unexpected at first sight: non-payments and barter.

The August 1998 crisis, another turning moment in Russia's economic transformation, proved to be a logical outcome of 1992-1998 policy. Economic literature reproduces a traditional conception of the crisis as either currency or budgetary one. We hold both the first and second component intervened rather as an initial impulse or external manifestation of the crisis; the causes of its depth and scale of impact on the economy consist, however, in the fact that it overlapped the transformation crisis not totally overcome when, for instance, such a phenomenon as non-payments were peaked in their development. The 1998 crisis stroke a destructive blow to the new market economy institutes in formation - banks and stock market; the latter, by the way, was particularly hit and actually paralyzed until the onset of the 2000s. Nevertheless, after overcoming the outcomes of the crisis, in conjunction with the changed external conditions, Russian economy entered a new stage in its development.

The third stage (1999-2007) was characterized by sustainable economic growth. Over this period the country's real GDP increased by 69 percent, fixed capital investment by 152 percent, retail trade turnover by 128 percent.

²⁴ Calculated on the basis of: http://www.gks.ru/bgd/regl/b08_11/IssWWW.exe/Stg/d02/14-03.htm.

The key sources of economic growth changed periodically over this period. The first impulse for economic growth was a considerable fall of the real ruble exchange rate under the impact of a steep decrease of its nominal rate. The real exchange rate of the Russian ruble in September-December 1998 lowered up to 50-60 percent of the first half-year indicator. But already in 1999 the ruble strengthened by 1.7 percent in real terms against the dollar.²⁵ Later the growth process of the real ruble exchange rate exerted a rather suppressing influence on export of non-raw sectors. The next impulse was growing oil prices on the world market beginning with 2000. In 1999-2007 world oil prices in US dollars picked up almost four times.²⁶ A considerable inflow into the country of currency earnings from energy export created a stimulus for domestic demand growth: first of consumer demand and after 2003 also of investment demand.

In the 2000s a discussion on the main economic policy direction was underway. On the one hand, the financial bloc of the government made its main emphasis on the need to lower the inflation rate since from 2000 on this process in Russia went rather slowly (the average annual inflation rate sank from 20.8 percent in 2000 to 9 percent in 2007²⁷). On the other hand, the standpoint was expressed (among others also by economists of the Russian Academy of Sciences) the current favourable economic situation should be used for economic restructuring, and accent made on active social and industrial policies. It is to be noted that the second position gradually made its way in the power institutions.

Meanwhile, a specific combination of budgetary and monetary policy measures aimed at simultaneously solving several tasks was applied. The monetary policy turned out to be mainly oriented at preventing steep strengthening of the ruble by way of buying foreign currency on the domestic currency market, and increasing currency reserves, which was justified by the idea of support for non-raw export. Simultaneously channels were set up to withdraw - to the benefit of the state budget - the rent gained from sales of fuel and energy resources; with a favourable external situation, this ensured a state budget surplus from 2000 on, its amount against GDP reached a considerable value from 2004 on. Taking into consideration the fact that currency interventions of the Central Bank imply a certain inflationary effect (they provoke increase of money supply in the country) it was decided to make use of the opportunities offered by the budgetary policy to sterilize excessive money supply. With this end in view in 2004 the so called Stabilization Fund was set up, which, beginning with February 1, 2008, was divided into Reserve Fund and National Wealth Fund. In this way the authorities managed to a certain degree to regulate the dynamics of exchange rate and prices although neither of the problems (ruble strengthening and inflation) was solved.

As a result, considerable funds in form of foreign currency reserves were withdrawn from circulation, their amount reached \$474 bln by the end of 2007. But a part of these funds not connected directly with the function of supporting a stable exchange rate might have been used, in case economic trends change, to assist the development of national economy (for example, in form of foreign currency loans). Hence, we can state the problem of Russia's economic modernization not tackled in 2000-2007 (see below) could have been solved, among other things, by attracting funds allocated in form of excessive currency reserves.

As relatively new and, in our view, favourable shifts in economic policy turned out to be measures linked with enhanced emphasis on social and structural components. We mean in

²⁵ Godovoi otchet 1999 / Tsentralnyi bank Rossiyskoi Federatsii. M., 2000. S.51 [*Annual Report 1999 / Central Bank of the Russian Federation. Moscow, 2000. P.51*].

²⁶ Calculated on the basis of: World Economic Outlook. Database. International Monetary Fund. 2008. April (www.imf.org).

²⁷ World Economic Outlook. October 2008. Washington DC: IMF, 2008. P.270.

particular the launching of so called national projects in education, healthcare, housing construction and solution of social problems in the countryside as well as the trend to develop certain sections of machine-building (which found themselves in a deep crisis during the transformation process, for example, aircraft construction), set up a Development Bank, form a strategic planning system.

On analyzing the period since 1985 we can draw the following conclusion: the outcome of a lengthy transformation process is formation of a market economy in Russia, which reacts more or less adequately to corresponding signals. During the transition period, however, specific mechanisms of the economic system's reaction to the impact of the economic policy took shape in form of barter, non-payments, massive capital outflow. A serious problem is the insufficient level of economic agents' confidence in the policy pursued by the authorities.

Institutes typical for a market economy were established like a two-tier banking system, a stock market, which did not exist in the administrative economic system. In the 1990s the banking system remained weak and the stock market only started to take shape, in the 2000s they showed substantially better indicators. Aggregate assets of the banking sector amounted in early-2008 to 61 percent GDP (against 33 percent as of January 1, 2000), stock market capitalization in the period of its maximal indexes (2006-2007) was over 100 percent GDP.

We presume the transition to market economy has become irreversible though as before the economic models, which need to be developed in Russia, or, for example, the scope and forms of state intervention into the functioning of the economic system might be points of discussion.

The Current Condition of Russian Economy

Over the long period of economic growth (1999-2007) Russian economy, judging by its quantitative indicators, coped with the negative consequences of the transformation of the 1990s. According to the results of 2007, real GDP made 104.7 percent of the 1990 level as basic. But we should not forget developed economies continued their stable growth. In 1990-2007 real GDP of advanced countries increased by 59 percent. Other economies in transformation also showed more impressive results than Russia. In 1990-2007 real GDP of Poland picked up by 77.5 percent, Hungary 38 percent, Czech Republic 37.5 percent not to mention China where the indicator made 450 percent.²⁸ Compared to other indicators consumer demand and population's income show relatively favourable indexes. For example, in 2007 real disposable income of the population exceeded the 1991 level by 7 percent and retail turnover by 124 percent.

As to other indicators the transformation results are more depressing. For example, in 2007 industrial output in real terms made only 84 percent of the 1991 level, fixed capital investment 68 percent.²⁹

In the light of the outstripping development dynamics of other countries (both advanced and other economies in transition, not to speak of a series of developing countries) Russia's positions in world economy weakened. In 2007 Russia's share in global GDP accounted for 3.2 percent

²⁸ Calculated on the basis of: World Economic Outlook. October 2008. Washington DC: IMF, 2008. P.259-265.

²⁹ The indicators are calculated on the basis of: 15 let Sodruzhestva Nezavisimykh Gosudarstv (1991-2005): Stat. sb./Mezhgos. Stat. komitet Sodruzhestva Nezavisimykh Gosudarstv. M., 2006. S.51 [*15 Years of the Commonwealth of Independent States (1991-2005): Statistical Collection / Interstate Statistical Committee of the Commonwealth of Independent States. Moscow, 2006. P.51*] and the Ministry of Economic Development of the Russian Federation data (www.economy.gov.ru) for 2006-2007.

and in world commodity and services export for 2.3 percent.³⁰ True, compared to the previous decade obvious progress was achieved: then the indicators made 1.9 percent and 1.5 percent, respectively.³¹ If we address the qualitative indicators of economic development then, for example, per capita GDP adjusted to the purchasing power parity amounted in 2005 to 91 percent of the 1989 level (according to the latest available data of the UN Development Program). In the period of 1990-2005 the indicator contracted at the average rate of 0.1 percent a year. Over the same period per capita GDP of France, Germany, Italy grew at the average rate of 1.3-1.6 percent a year, in Spain, Finland, Australia 2.5 percent, Ireland 6.2 percent; and among other countries in transformation: in Bulgaria 1.5 percent, Czech Republic 1.9 percent, Hungary 3.1 percent, Poland 4.3 percent.³² As to the place of Russia among other countries by the dynamics of per capita GDP (Table 1) we see the changing indicator mirrors shifts in the economic dynamics of the country as a whole: over the 1990s the country's indicator was falling in the world ranking (from the 52nd place in 1992 to the 77th in 1995), then it rose in the 2000s (in 2006 Russia occupied the 55th place in the world in per capita GDP).

Table 1

Qualitative indicators of Russia's economic and social development

	1987*	1990*	1992	1995	1998	2000	2002	2006
HDI value	0.920	0.873	0.858	0.769	0.771	0.781	0.795	0.806
Rank	30	33	34	72	62	60	57	73
GDP per capita	6000**	6270***	6140	4531	6460	8377	8230	13205
Rank	34**	38***	52	77	59	58	60	55
GDP, bln. doll.	...	...	...	...	331.8**	251.1	346.5	763.7****
Rank	...	...	...	...	16	17	16	14****
GDP, bln. doll. at PPP	...	...	...	...	...	1219.4	1185.6	1552****
Rank	...	...	...	...	...	10	9	9****

Sources: Human Development Reports. UNDP. Different Issues.

Notes:

HDI – Human Development Index

The rank index is determined according to the country's place by the index among the totality of countries in consideration.

GDP per capita – GDP per capita of population measured in dollars at purchasing power parity.

PPP – purchasing power parity.

* Indicators for the USSR.

** Instead of GDP the index of gross national product (GNP) was used.

*** Data refer to 1989.

**** Data refer to 2005.

On analyzing the qualitative indicators of Russian economic development we find out Russia stands substantially lower in the human development index (HDI) as an integral index.³³ In the

³⁰ World Economic Outlook. October 2008. Washington DC: IMF, 2008. P.253.

³¹ World Economic Outlook. October 1998. Washington DC: IMF, 1998. P.160.

³² Human Development Report 2007/2008. UNDP, 2007. P.277.

³³ The index measures basic aspects of human development: standard of living (by GDP per capita of a country's population), health (by average by life expectancy at birth), and education (by the level of literacy rate and the enrolment ratio).

late-1990s the USSR took the 34th to 38th places in the world in HDI value but in the mid-1990s Russia sank to the 77th place³⁴ and then somewhat amended her situation in the early-2000s thanks to per capita GDP growth, but already in 2006 she found herself again on a rather low 73rd place mainly due to the impact of one indicator - the average life expectancy at birth.

The results of 1992-2007 transformation affected individual economic sectors in a different way. Over this period real output grew in mining and quarrying of fuel and energy resources (by 17 percent against 1991), pulp and paper industry, publishing and printing industry (by 27 percent). In contrast, output in machine-building fell by 41 percent (though production of electric appliances, electronic and optical equipment increased by 51 percent), textile and textile production by 73 percent.³⁵ Thus, the shift towards extracting industries and low added value sectors became bigger.

Resuming the above we can draw the conclusion that by 2008 substantial positive results in economic area were attained:

- Quantitative and in part qualitative economic indicators at least compared to the misfortunate period of the 1990s improved.
- Elements of state industrial, social and regional policies came to be noticed.
- Efforts were applied to shape market institutes and the private-state partnership system.
- Natural rent was withdrawn more fully and transferred to the budget (through taxation of companies engaged in fuel industry).³⁶

At the same time a series of negative trends continued to take effect:

- Up to now the problem of diversification of the economy has not been resolved. It manifests itself with particular evidence in the structure of Russian export where as before fuel and raws play the main role.
- The science-intensive component of the majority of economic sectors stands on a low level, a gap still exists between fundamental and applied researches on the one hand and the real sector of the economy on the other.
- One of the bottlenecks of economic development remains the condition of the infrastructure, transport infrastructure included.

In 2007 the first signs of the world financial crisis came to be felt in Russian economy, already in 2008 critical phenomena affected Russia's financial system first and by the end of the year began to spread to the real sector of the economy.

During 2000-2007 the degree of Russia's involvement in world financial flows invigorated. This was in part a natural phenomenon linked with increased export earnings and improved general economic situation in the country; in part it was due to liberalization of currency legislation which implied abolition from July 1, 2006 of all restrictions in trans-border capital movement.

The two major channels, which helped the world economic crisis spread in Russia's economy, were non-residents' capital outflow from Russian financial markets and the falling oil prices. Both produced a considerable negative aggregate demand-driven shock.

³⁴ Although the fact of decreased quality of life in Russia cannot be denied direct comparisons of the cited ranks should, nevertheless, be made with caution since, first, the methodology of calculating individual HDI components changes constantly, and, second, with the break-up of the USSR and former Yugoslavia the number of countries as basis of calculating the HDI value has increased.

³⁵ Data by the Federal State Statistics Service (http://www.gks.ru/bgd/regl/b08_11/IssWWW.exe/Stg/d02/14-03.htm).

³⁶ K programme sotsialno-ekonomicheskogo razvitiya Rossii. 2008-2016. IE RAN. M., 2008. S.7 [About the Program of Socio-Economic Development of Russia. 2008-2016. RAS Economics Institute. Moscow, 2008. P.7].

Non-residents' capital outflow found its evidence in the stock indexes falling since June 2008 on the Moscow Interbank Currency Exchange (MICEX) and Russian Trading System Stock Exchange (RTS Stock Exchange). Later, since mid-July 2008 a swift softening of oil prices on the world markets followed. For example, Brent crude price per barrel sank from \$140-150 in July 2008 to \$40-50 in December 2008. This softening produced a negative effect on Russia's export indicators: from August 2008 on they began to decrease in dollar terms. Russian commodity export in January-March 2009 made only about 53 percent of the indicator of January-March 2008.³⁷

By late-2008 the negative trends in financial and foreign sectors of Russian economy embraced the real sector. The downturn of industrial production (compared to the corresponding period of the previous year) started in November 2008. During January-April 2009 industrial output sank by 15 percent against January-April 2008. Processing industry production contracted at an even faster rate like it was the case in Russian economy during critical periods when production in mining industry played the role of some kind of buffer to the spreading critical trends. The base for domestic consumer demand development contracted. In November 2008-January 2009 compared to the corresponding period of the previous year real disposable income of the population showed a monthly fall of 6, 1, 11.6 and 6.7 percent, respectively. Later it somewhat recovered and by the results of January-April 2009 remained practically on the level of the corresponding period of 2008.³⁸ All this lead to a contraction of the base for economic growth, whose fundament up to recently was domestic demand. In consequence, in the first quarter of 2009 real GDP shrank by 9.5 percent in yearly terms.

Negative trends seemingly gone with the end of the transformation crisis (for example, non-payments) showed up again. For example, over the period between July 2008 and April 2009 summarized wage arrears as of month-end grew more than three times and peaked in March 2009.³⁹

The reaction of the state to critical trends was in the first term connected with solving current problems: support for banking system liquidity, stock market revival, an even national currency depreciation (up to early-2009 when it became sweeping), etc.

Thus, in the second half 2008 a regular turning point in Russian economy started but its comparison with previous turning points (of 1985, 1992, 1998) gives us no reasons to assert the economy is awaiting catastrophes of similar depth.

The previous shocks in their essence were of domestic character, they were linked with transformation of the economic system, the current crisis was mainly caused by external factors. Of course, internal economic problems were also in place and remained partly in the shadow of favourable economic trends up to the present but they exteriorized during the crisis and aggravated its impact on the economy. Let us list the most important of these problems:

1. The dependence of Russian economy on the dynamics of certain sectors, whose production is exported, primarily oil and gas industry as well as metallurgy. The slump of world prices for products of these sectors entailed a meaningful contraction of Russian export. At the same time the current crisis shows that under conditions of expansion of critical phenomena across all

³⁷ O tekushei situatsii v ekonomike Rossiyskoi Federatsii v yanvare-aprele 2009 goda. Ministerstvo ekonomicheskogo razvitiya Rossiyskoi Federatsii, 2009 [*On the Current Situation in the Economy of the Russian Federation in January-April 2009. Ministry of Economic Development of the Russian Federation, 2009*]. (<http://economy.gov.ru>).

³⁸ Data of the Ministry of Economic Development (www.economy.gov.ru).

³⁹ Data of the Ministry of Economic Development (www.economy.gov.ru).

countries and all sectors of world economy diversification of national economy is insufficient to bar it from the negative influence of external shocks. A considerable domestic market of manufacturing products is also needed.

2. The insufficient development level of Russia's banking system and financial market. Despite considerable growth of quantitative indicators of their evolution they lagged behind, to a considerable degree, by these indicators and, in particular, by the quality condition these areas enjoy in developed countries. As already mentioned, assets of the Russian banking system increased to 61 percent GDP as of January 1, 2008⁴⁰ against eurozone countries' bank assets making on the average about 250 percent GDP according to 2007 results.⁴¹ Despite the fact that before the crisis Russian stock market capitalization achieved more than 100 percent GDP, the turnover on shares at MICEX amounted by 2007 results to nearly 46 percent GDP, the lion's share of the turnover fell on some of highly liquid shares. A major problem in the development of the stock market was a considerable presence of non-residents with about one third of their market share on the MICEX immediately before the crisis.

3. The economic agents' low confidence level to each other and to the economic policy carried out. The problem was evidenced by considerable capital outflow during the crisis and significant pressure on the ruble exchange rate emerged on the domestic currency market – a trend, which required serious Central Bank interventions.

4. The problem of economic policy tools applied. In particular, currency liberalization of the mid-2000s created additional critical risks, and the policy of accumulating excessive foreign currency reserves entailed the withdrawal of assets from circulation and a reduction of opportunities to modernize the economy. The cutback of foreign currency reserves in the critical period illustrates the alternative costs of a similar policy. If we take the maximal pre-crisis oil price (of about \$140-150 a barrel, or nearly \$1,088 a ton), the reserves spent would be equal to lost 197 mln tons of oil as a minimum transported abroad, a figure close to the annual export indicator for Russian oil. These costs might have been at least partly avoided if currency regulation tools were applied.

In spite of existing domestic problems external factors played a dominating role in the expansion of the crisis, and that is why the analysis of their impact on and their importance for Russian economy over the transformation period is of special significance.

The Effect of External Factors for Economic Development

The role of external factors in Russia's economic evolution increased with the opening-up of her national economy to the external world. Among the principal factors oil price dynamics on the world markets is traditionally underlined because it impacts on the revenues from the main items of Russian export (oil and natural gas). The data given above testify this regularity had effect over the whole period in consideration. The slump of world oil prices in the mid-1980s, early 1990s, 1997-1998 really overlapped the development problems experienced first by soviet and later by Russian economy. But in the period up to the 2000s the role of the external impact should not be absolutized since development of the economic sphere was mainly determined by internal factors linked with accumulated problems of planned economy and subsequent economic transformation (and the model of its realization).

⁴⁰ Obzor bankovskogo sektora Rossiyskoi Federatsii. Internet-versiya. 2008. Dek. N74 [*Review of the Banking Sector of the Russian Federation. Internet Version. 2008. December. No.74*].

⁴¹ CEE Banking Sector Report. 2008. September. Raiffeisen Research, 2008. P.9.

As transformation processes developed the influence of trans-border capital movement on Russian economy gained momentum. In contrast to countries of Central and Eastern Europe (where direct foreign investment inflow turned into the essential factor of economic growth and economic restructuring) Russia did not succeed in attracting large-scale direct foreign investment (several recent years are an exception).

From the point of view of participation in global capital movement in the 1990s the dominant trend in Russia was capital flight. Its precise quantitative estimates are difficult to make because of imperfect statistics of the phenomenon and the desire of economic agents to apply various 'schemes' of draining out capital from Russia. According to our estimates based on the balance of payments, in 1993-1999 the fugitive capital volume made \$90-115 bln.⁴² Due to imperfection of statistics used this value may be taken as the low margin. Over the 2000s fugitive capital grew in scale but the importance of the phenomenon lowered at the background of the increased export volume. The problem of capital flight from the country became very acute with the 2008 financial crisis. The outflow of non-residents' capital was followed by the flight of Russian capital from the country. In the last quarter of 2008 net capital outflow undertaken by the private sector registered a record figure of \$130.6 bln; in the first quarter of 2009 the trend continued in lesser scale: net capital outflow made \$38.8 bln.⁴³ From the perspective of national economy development capital flight mirrors lost opportunities in both investment within the country and its modernization. At the same time a purely 'monetary' approach to the phenomenon exists: it focuses on the fact that capital outflow in the 2000s allowed to mitigate the pressure towards money supply growth in the country, which emerged due to growing export proceeds. This approach, however, fails to take into account a considerable need for investment in Russian economy manifested, among other things, in a low savings ratio.

Another negative phenomenon linked with the impact of external factors was dollarization of Russian economy, particularly high in scope in the 1990s. Dollarization acquired mainly two forms: foreign currency deposits in Russian banks, and purchase of cash foreign exchange (notably US dollars) by economic agents. According to our estimates, the dollarization level (measured as a ratio of foreign currency deposits to money supply in its broad meaning) peaked in the first half of the 1990s and after the 1998 crisis up to the early-2001 when its stable decrease began.⁴⁴ Viewed through the prism of national economy regulation, dollarization contracts the opportunities of the monetary policy because the Central Bank practically lacks tools to impact on the part of money supply represented by foreign currency (particularly in cash). Besides, the Central Bank is compelled to pay more attention to regulate the ruble exchange rate when a considerable share of economic agents' liabilities is denominated in foreign currency. This concern was clearly expressed in the policy of controlling ruble depreciation in the second half 2008.

It is worth mentioning that in 2000-2008 the pattern of Russia's participation in global financial flows changed qualitatively. Earlier (in the 1990s) the state increased step-by-step its foreign debt to resolve budgetary problems, companies and banks drained out capital. In the 2000s the situation changed to the opposite. The improved situation in public finances, growing foreign currency reserves on the account of inflow of export proceeds plus simultaneous clearing-off the accumulated state foreign debt allowed a situation in which the Russian state and its financial

⁴² In our estimates the following items of the balance of payments were analyzed: Trade credits and advances, Non-repatriation of export proceeds, non-supply of goods and services against import contracts, and Net errors and omissions.

⁴³ http://www.cbr.ru/statistics/credit_statistics/print.asp?file=capital.htm.

⁴⁴ Golovnin M.Y. Dollarizatsiya v perekhodnykh ekonomikakh Rossii i stran Tsentralnoi i Vostochnoi Evropy // Problemy prognozirovaniya. 2004. N3. S.126 [Golovnin M.Y. Dollarization in Transition Economies of Russia and East Central Europe // Problems of Forecasting. 2004. No.3. P. 126].

authorities began to extend more loans to the rest of the world whereas corporations and banks to actively borrow abroad making use of low interest rates on the world market, a falling country risk premium for Russia and a growing ruble exchange rate. In consequence, the external debt of state governing and monetary regulation bodies was reduced from \$149 bln as of January 2000 to \$39 bln as of July 1, 2008, and the foreign debt of banks and non-financial institutions increased from \$29.2 to \$488.3 over the same period.⁴⁵ In the end, currency risks were re-distributed from state to corporate borrowers, but only partially, since many of the latter were in state property.

Hence, at present Russian economy comes to experience the impact of several external factors, among them the main factor is still the dynamics of world energy prices and, additionally, the dynamics of the Central Bank interest rate in major world currencies, of the stock markets in developed and developing countries, the condition of world economy, the exchange rate regime of key currencies (in the first place, dollar and euro).

All this was clearly shown by the present economic crisis. The first impulse for its expansion on Russian economy was the outflow of foreign investors' funds to their national markets when their financial situation exacerbated. The negative trends deepened later because aggregate demand in Russian economy shrank due to lower proceeds from export-oriented raw productions (in the 2000s their export proceeds allowed them to heavily stimulate aggregate demand in the country).

In this connection the question arises again about the expediency of a full-scale currency liberalization carried out in the country. Practice testifies that under conditions of spreading critical trends economies more open to financial flows, particularly short-term, with less developed financial markets are more vulnerable.

A Long-Term Forecast of Main Trends and Practical Recommendations

The evaluation of development prospects for Russian economy depends at present on how deep and durable the current crisis will be. The best scenario envisages a recovery of Russian economy starting by the end of 2009 thanks to resumption - since early-2009 - of oil price growth on the world markets.

The feasibility of any scenario of future economic development depends on the economic policy pursued by the country. The authorities adopted measures already to ensure the liquidity of the banking system and assistance to individual economic sectors. But the process of allocating funds in the real economic sector through mediation of the financial system experiences serious difficulties. In many aspects it is linked with negative expectations as to the dynamics of aggregate demand. Banks do not extend credits to enterprises because they do not see any perspective of demand growth for their products. Besides, banks include in their interest credit the foresight of higher risks. In these conditions the government has to lay main emphasis on stimulating aggregate demand. To this end it should finance big programs oriented at infrastructure development, technical modernization of production and its restructuring. Financial resources should be allocated in the scientific-production complex to promote designs, production, export and introduction of high-tech products in the country. In our view, the problem of using a part of foreign currency reserves to import modern technologies and equipment to comply with the modernization program of Russian economy remains pressing as before. Under present conditions it is also important to conserve traditional sectors of Russian export, fuel and energy among them. To raise their efficiency the share of funds withdrawn in

⁴⁵ According to data of the Central Bank of the Russian Federation (<http://www.cbr.ru/statistics/>).

favour of the federal budget should be reduced because, with the oil prices formed during the crisis, it is already not the rent that is withdrawn but net profit, which might have been deployed to develop natural resources extraction – a sector which faces already serious restraints in the perspective. All these measures in their totality will help Russian economy in the long run as well, after the current crisis is over.

Support of final demand will require a transition to a budget deficit,⁴⁶ which will make it necessary to use the accumulated reserves as well as make domestic borrowings. Here the French experience may be applied: in this country commercial banks were compelled to invest a part of their assets in securities issued by the state, but they had the right to pledge them as collateral to get loans from the central bank.

As to the long-term perspective, forecasts made up to recently (including in Russia) were mainly based on pre-crisis trends in Russian economic development extrapolated for the future. Many of them proceeded, in particular, from retained high oil prices in world economy.⁴⁷ Of course, it is quite reasonable to suggest oil prices would resume its growth but the previous experience of Russian transformation indicates it is not a very reliable source of economic growth in the long run. Besides, resource restraints in the fuel and energy economy linked with a gradual depletion of functioning deposits and the need to augment investment to develop new ones start to become more and more evident. The Global Trends 2025: A Transformed World, a report prepared by the US National Intelligence Council is worth mentioning here. It holds Russia's economic positions could experience a significant decline if oil prices remain in the \$50-70 per barrel range (we have to note that during the crisis they already fell below the margin). But among other important prerequisites for possible strengthening of Russia's positions in world economy investment into human capital and diversification of national economy are indicated.⁴⁸

In our view, the prospects of Russia's economic development up to 2025 and a still longer perspective depend on whether we succeed to attain qualitative shifts in this development, first of all structural changes in the economy, allowing to abandon the still existing and in essence one-factor pattern of economic growth and prefer to develop the scientific-technical potential and implement it in production, improve human capital. Let us note: this is mainly the same range of problems the soviet economy faced before *perestroika*.

Immediately before the world crisis expanded to Russia the Ministry of Economic Development devised the Conception of Long-Term Socio-Economic Development of the Russian Federation up to 2020.⁴⁹ The main emphasis is made in the document on raising the quality of human capital, higher compatibility of Russian economy, structural diversification of the economy on the basis of innovative technological development and several other lines. The statement of these goals cannot but be approved of. The opportunity to realize the goals set will depend on the impact of the current economic crisis on the development of the world economy (including its possible consequences seen through the prism of structural shifts and the dynamics of world financial system). In the nearest future Russia might not enjoy a favourable external situation like the one faced in 2000-2007 (Table 2). Moreover, international competition will more likely become tougher in those 'break-through' innovation lines, which Russia will choose for herself.

⁴⁶ In February 2009 the federal budget deficit amounting to 8.8 percent GDP was already registered.

⁴⁷ For example, the Conception of Long-Term Socio-Economic Development of the Russian Federation up to 2020 (approved by the decision of the government of the Russian Federation no.1662-p as of November 17, 2008) presumes an average annual oil price within the range of \$90-110 a barrel (see Annex 1 to the Conception).

⁴⁸ Global Trends 2025: A Transformed World. National Intelligence Council, November 2008. p. vii.

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<http://www.economy.gov.ru/wps/wcm/myconnect/economylib/mert/welcome/pressservice/eventschonicle/doc1217949648141>.

Against this background state economic policy oriented at long-term development will be extremely important. It is necessary to maintain the trend outlined - support a higher scientific-technical level of production, shape an innovative economy - and not sacrifice them to an abstract goal of combating inflation or shifting them to 'the sidelines' while deploying the shrinking budgetary funds. If despite temporary critical trends we succeed in maintaining the line of active industrial and social policies, setting up institutional conditions for a new model (competition development, economic policy 'tuning' to attain innovation economy goals), then the chances to have the optimistic scenario realized will rise. In this case Russia will have the opportunity to enjoy long-term growth at a rate exceeding the current trend in world economy (economic growth of about 3-4 percent a year over the last decade) and to strengthen her overall positions in world economy. But this will mean growth on another basis, not high energy prices, and growth less vulnerable to fluctuations, inclusively under the impact of external factors. Russia will be able to become the centre of attraction for neighbouring countries not only as energy supplier but also as a world scientific-production enter.

Table 2

Main Macroeconomic Indicators for Russia in 1991-2008

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Real GDP growth rates, in percent	-5.0	-14.5	-8.7	-12.7	-4.1	-3.4	0.9	-4.9	5.4	9.0	5.0	4.3	7.3	7.2	6.4	7.4	8.1	5.6
Industrial production growth rates, in percent	-8.0	-18.0	-14.1	-20.9	-3.3	-4.5	2.0	-5.2	11.0	11.9	4.9	3.7	8.9	8.0	5.1	6.3	6.3	2.0
Fixed capital investment growth rates, in percent	...	-40	-12	-24	-10	-18	-5	-12	5	17.4	10.0	2.8	12.5	13.7	10.9	16.7	21.1	9.0
Average annual growth rates of consumer prices, in percent	160	1530	874	308	197.5	47.8	14.8	27.7	85.7	20.8	21.5	15.8	13.7	10.9	12.5	9.7	9.0	14.1

Sources: Federal State Statistics Service; Interstate Statistical Committee of the Commonwealth of Independent States; The Vienna Institute for International Economic Studies (WIIW) Research Reports; World Economic Outlook. October 2008. Washington DC: IMF, 2008.