

Moscow 4/96

Russian Local Govts

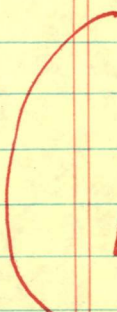
Oblast E.g. Moscow, 7m. pop.



Rayon E.g. Odintsovo, 4% of Oblast pop.



City, Village, farms. Overlain by grid of "Local Soviets"



Rayon administers ^{3 kinds of} prop. tax; keeps 60%, sends 40% to Oblast.

3 kinds of prop tax

A. On land

B. Structures owned by orgs.
Is part of a genl. tax on assets of an orgn. - includes some l.v. Rayon gets 50%; Oblast 50%

C. Structures owned by individuals.

2
Rayon keeps all. Nominal,
negligible, informal.

Source: Joan Youngman.

London, Nov. '93

Nat. Res. Comm. of Russia focuses on extractives

2-3 ^{day} Congress in the Russia

I.U. will sponsor 4 Eur. speakers

Big affair. 12 or more speakers.

Nic turns people off w. hi-falutin theme

Gennady Sukhomin, CB, probable next presid.

Our man is Vice Chair of Nat. Res. Zvolinsky.
Dr. Viacheslav.

✓ How borrow up land as collateral. Ed Dodson
will cover. Prepare on this, tho. Ask Ted

✓ Focus on ALTB, + water, timber, oil & gas

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Bard College on Levy Symposium

Reproductive structure

Reforms toward open mkt.

1. Condition of the ec. + + -
 - + a. Can buy anything - consumer goods
 - + b. New centralize & intn. of ec.
 - a. after 1991, no progress toward mkt.
 - b. Fall of ruble, by $\frac{1}{3}$. Govt. cannot govern the ec.
 - c. '90 - '94, ~~that~~ ^{shocking} drop in produ. as bad as a nuclear war.
 - d. Mansions being built all around Moscow. Growing inequality.
 - e. Majority is rejecting reforms
 - f. Lowest wages in world, with rich
- less
 - g. Monopolism - a relation, unrelated to size.

2. Inside reasons for fall of ruble.
 - a. 4% of salaries are not being paid

Lvov - 2

b. Either raise prices or go bankrupt
c. Need to use Nat. res. & energy, but reforms are not doing so. are underpricing energy, overpricing machinery, food, constr.
Is 70% of "total net returns" of Rus. ec. evaluated at world prices - but 12% valued at Rus. prices.

d. MP of $K < 0$; MP of R (rent) is very high

e. Payroll tax + VAT raise most rev.; but resources acct. for most inc.

3. Proposal

Abolish all taxes except on natural res., we cd. Δ activity to "very high level."
✓! Govt. fears ΔP if do so. **Monetarist**

dilemma - mangleing.
fear of oversupply!

Cf. Keynesian dilemma:
Compare.

How to End Russian Inflation

Dmitry Lvov, Deputy Director
Central Institute for Economics and Mathematics (TsEMI),
Chairman, Economic Policy Continuing Discussion Group, Moscow

The economic policies that Russia has adopted at the urging of the World Bank and other international institutions have not produced good results for Russia. Industrial output has declined by more than 50% in five years. This exceeds the decline in production in Russia in the Second World War and the decline in production in the U.S. in the Great Depression. The decline in production in machinery and light industry has reached 70 or 80 percent. The rate of inflation in the middle of 1994 slowed slightly, to the great pride of our government. But last month's rate of inflation was three to five times as large as the rates in the summer.

To deal adequately with Russian inflation, its cause must be properly understood. The roots of Russian inflation go back to the former centralized system of planning and management. From that period we inherited technological obsolescence and pervasive monopoly, two factors that contributed significantly to our current regime of rising prices.

Because of the technological obsolescence and pervasive monopoly in Russian industry and agriculture, the greatest part of Russian manufacturing and agriculture output became unsalable at world prices when our economy was opened, even with our extremely low wages (typically \$60 per month). See Table 1. In an open economy, there were two very unpleasant alternatives for Russian enterprises: either close the factories, producing to massive unemployment, or try to save the enterprises through ever higher prices. Of course, managers chose the second alternative, and politicians supported them with subsidies financed by printing more rubles, because the alternative of massive unemployment was unacceptable. But the resulting high prices gave us very sharply reduced demand, and therefore declining production.

As the value of the ruble inevitably fell, and the artificially high Russian prices approached world prices, monopoly producers sought to raise prices again. But it was not possible for all sectors to have prices that exceeded world prices. The effort to raise prices throughout the economy caused a flood of imports that filled the country and consumed all available currency resources. Then feedback mechanisms began to work. The value of the ruble fell, and internal prices approached world prices again. This circle, repeated many times, became the basis of Russian inflation. If Russia continues on its present course it will be ruined before the end of the century.

Technological obsolescence and monopoly cannot be accommodated by high prices in an open economy. The Russian economy must be put on a competitive basis. To do this, we desperately need to change tax policies. Taxation must not burden production. The 40% payroll tax, the 30% profits tax, the 20% VAT and the progressive income tax take a terrible toll on the competitiveness of Russian industry.

A model of the Russian economy has been developed by the scientists at TsEMI over the past two years, under the supervision of Prof. Lvov and in collaboration with businessmen and

members of parliament. This model deals with the impacts of taxes and price liberalization on the economy, and the potential impact of tax reform. This model indicates that all of these taxes accelerate inflation and exacerbate the decline in production.

To have a productive Russian economy, the primary basis of taxation must be the collection of rent for the use of natural resources and land. At present, Russia gets about less than 10% of its public revenue, directly or indirectly, from natural resources and only 0.04% from taxes on land. In oil and gas alone, there is an untapped potential for public revenue of about \$30 billion, which is the same amount as the deficit in the budget approved by the Russian Duma. See Table 2. If natural resources and land are made the primary basis of public revenue in Russia, as outlined in Table 3, the industrial and agricultural sectors will receive a tremendous boost. They will be able to compete in the world market. This is of the utmost importance for their development. A model developed by the Russian Academy of Science showed that this change in the tax system would allow Russia to cut its inflation rate in half and regain half of the fall in output that it has experienced.

We hope that the discussion of these ideas at Bard College will increase understanding of their desirability and attract the attention and support of American economists. We look forward to the chance to collaborate with our American colleagues on the design of institutions for managing the public sector under these institutions, and for easing the transition to it.

TABLE 1
The Structure of Net Returns in Russia (1993)

Sectors	Percentage of total net returns	
	Evaluated at ruble prices	Evaluated at world prices
Metallurgy	5	8
Fuel and Energy	12	70
Chemicals and timber	10	13
Machinery	25	7
Light Industry	10	-2
Agriculture	18	-10
Construction	10	8
Other	10	6
Total	100	100

TABLE 2

Rent from Oil and Gas

Year	Oil				Gas				Total Rent Bil. of \$	Per- cent from gas
	Output		Rent in \$ per ton	Rent Bil. of \$	Output		Rent in \$ per TCM	Rent in Bil. of \$		
	Mil. Tons	% of 1992			Thous. of cu mtr	% of 1992				
1992	374	100	34.8	13.0	559	100	40.2	22.5	35.5	63
1993	329	88	27.6	9.1	575	103	40.4	23.2	32.3	72
1994	315	84	20.8	6.5	591	106	40.6	24.5	30.5	79
1995	306	82	14.2	4.3	608.3	109	40.8	24.8	29.1	85

TABLE 3

Taxes and other Public Revenue in Russia in 1994

Type of tax or revenue	Existing Structure in 1994	Proposed Alternative
VAT	15.0	-
Profits Tax	17.0	12.0
Income Tax	4.0	-
Tariffs	8.6	11.3
Natural Resource Revenue	1.5	18.3
Land Tax	0.04	6.0
Revenue from Privatization	0.6	12.4
Property Tax	3.7	7.4
Ecological Tax	0.26	10.0
Tax on Capital Exports	—	5.6
Excise Taxes	6.3	5.0
Payroll Tax	32.0	3.0
Other Taxes	11.0	9.0
Total	100.0	100.0



ФЕДЕРАЛЬНОЕ СОБРАНИЕ — ПАРЛАМЕНТ РОССИЙСКОЙ ФЕДЕРАЦИИ

ДЕПУТАТ
ГОСУДАРСТВЕННОЙ ДУМЫ
1996 — 1999

“ 25 ” April 1996 г.

№ 3

DR. MASON GAFFNEY

Dear Dr. Gaffney,

I have pleasure in inviting you to address the conference "Problems of Land Relations in Russia" which will be held at the Parliamentary Centre, Tsvetnoi bulvar 2, Moscow, on May 21.

The conference is being held by the State Duma of the Russian Federation following the initiative of the Power to the People group of Deputies, which was supported by the agrarian group of Deputies and two committees of the State Duma.

V.P. Zvolinsky
Deputy, State Duma
Chairman,
Conference Organising Committee

RUSSIAN ACADEMY OF SCIENCES
CENTRAL ECONOMICS AND MATHEMATICS INSTITUTE
Independent economic association IEA-CEMI

PRACTICABLE COURSE OF ECONOMIC REFORMS
IN RUSSIA
(Concept, principles and proposals)

Dmitri Lvov

Moscow - 1994

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1. Introduction

This is not a secret for anybody that economic reform takes the way quite different from a supposed one.

First of all this is explained by the fact that the government either tries to stay apart from the developments of transition to market in hope that they will go on independently or it doesn't have real power to carry out the economic policy of transition to market. Most probably both reasons take place.

The economic science was not equal to the occasion as well. It was impossible but to mark some negative tendencies which are gave evidence apparently in the first years of restructuring - jointing of economic science with executive branch of the government. This couldn't but be counted on curtailment of the strategic researches of market problems, its substitution by insufficiently checked up recommendations. The criteria of truth became to recede in the background. The populism became a norm instead of serious theoretical elaborations.

The crisis in the economy was in essence a reflection of the crisis in the economic science, which came long before restructuring. It is the truth that only one ideology has dominated tens of years and any deviations from it was regarded as recreancy.

We can be surprised only how it was turned out that one mainstream flow in economic science, namely mathematical economics in CEMI was managed to survive at that dark time. It is in this institute the principles of the optimal functioning theory were elaborating successively. Unfortunately this sound basis remained unclaimed. And this was not by chance. The old generation of economists had very vague notion about researches in CEMI. "The birthmarks of socialism" were counted on their ideas concerning the ways of transition to market. The young economists though were free from Marxist dogmata but were guided by the West, by the classical researches on monetarism.

Some of our "mature democrats" have also outgrown the market romanticism. They, properly speaking, have blessed coming to power the new wave reformers. Then when enlightenment came it was already late: the economy had been destroyed and the criticism of reformers had no addressee.

Our country started with a highly raised banner, which read: liberalisation, stabilisation, privatisation. We were ready to pay. And we did pay because it had to be done at any price. But as a result some other words sparkle on the walls of our common house: infaltion, stagnation and speculation.

That was the price we had to pay for our market romanticism. It goes without saying that the problem of course is not the fallaciousness of the market transformation idea as itself and in poor practical knowledge of our young reformers. Frustrating results of the first reforming years are the direct consequence of the failure to prepare theoretically grounded economic reforms in Russia.

This report represents an attempt to make up for this deficiency and formulate some crucial proposals on reforming the Russian economy which are based on the principals of the efficient management.

This report is prepared by D.Lvov, the RAS corresponding member, deputy director of the Central Economics and Mathematics Institute (CEMI RAS). V.Pugachev, V.Dementiev, Yu.Ovsienko, Yu.Suchotin, A.Pitelin, S.Graborov, V.Gerasimovich, A.Petrov, L.Gelman as well as RAS Energetic Problems Institute (director A.Makarov, the RAS corresponding member) are among the contributors to this report.

The text of this report is available both in the Russian and in the English.

2. On theoretical basis of reforms

Three most important points should be marked out in the process of the situation at our theoretical front analysis:

- 1) superficial or one-sided perception of the modern tendencies in the western economic concept by scientific community;
- 2) disregarding of serious theoretical elaborations in home country;
- 3) misunderstanding of the specific features of transition to the market economy of such country as Russia.

In the process of conceptual study of reforms the criticism of the natural-distributive economy has lead to the other extreme: to the confidence in omnipotence of the financial self-regulation mechanism, to the neglect of the importance of state regulation of market processes. Naturally, many years of dogmatism have affected this area, too. Monetarism has replaced Marxism. As usually reformers have begun to implement the monetarist ideas. But, monetarism is only one of the western economic concepts, among which there are institutionalism, theory of the property rights, evolutionism, etc.

For example from the theory of the property rights it follows that directive regulation, being an alternative to the market self-regulation, is not an antipod to the market. It is the market's product and important constituting element. It is exercised not only by the state but by the business itself.

Institutionalism exposes peculiarities of the modern ideas concerning the goals of the society. First of all, it is rejection of "boundlessness" in achievement of personal and group goals ("the freedom of each person is finished there where the freedom of other persons begins"). That's why in western economies particular attention is paid to human capital, which becomes the most expensive factor of production. It is supported by rapidly increasing social transfers - redistribution of incomes in favour of poor strata of society etc.

It's important that each mainstream of the western economic idea doesn't pretend, and can't pretend on to be universal. And only joint consideration of the positive points of each of these mainstreams, including monetarism, may be successful. It is their interaction that leads to the complete understanding of the market economy essence.

Ignorance of their own theoretical heritage by the ideologists of the economic reforms in Russia was a very serious gap as well. First of all, we are talking about the well known theory of the economy optimal functioning (TEOF) which was elaborated since the beginning of the 60-ies in the Central Economics and Mathematics Institute of the USSR Academy of Sciences (CEMI).

The TEOF was an alternative to the economical apology of the national economy management methods which had been prevailing at this time. Authors of the TEOF had begun the study of the methodology of keeping economy active, that is the study of the principles of the rational construction of the economical relations system, economic interests and formation of their motivations.

A number of social and economic principal research postulates were developed in frame of TEOF. First of all we have to mention the systematic analysis of the studied phenomena, including the combination of physical and value aspects of economic development, "vertical" (between levels of hierarchy) and "horizontal" relations, impacts of individuals on the enterprise performance and the national economy as a whole using the democratic mechanisms.

The main result of TEOF is evaluating all kind of resources by the measure of their contribution to the final goal, the satisfaction of all demands of the society. Not only labour but other limited production factors such as natural, capital and other receive their evaluation within TEOF. Overcoming the limitations of the labour cost theory and large-scaled economic errors that resulted from its use is an undoubted TEOF's merit.

Based on the strict scientific foundations, the role of a number of general economic characteristics such as the capital investment, efficiency norm, payment for funds, credit interest rates and rent has been revealed. The concept of the optimal strategy for the development of the economy has been worked out. Already in the 70-ies this allowed to formulate the theoretical premises for creation of the regulated market type economic mechanism. This was the reason for the unfounded and incompetent criticism against TEOF, that resulted in periodical disappearances of the term TEOF from publications. The last ideological massacre occurred during 1983-1985, right at the beginning of perestroika. This allowed CEMI's opponents achieve their main goal, to take the TEOF and CEMI out of the transformation process. Unfortunately, the RAS Economics Division haven't yet principally appraised this immoral action.

3. Peculiarities of the economy

In elaboration of the strategic policy it's very important to take into consideration the specific peculiarities of the Russian economy. To large extent the failures of reforms are explained by neglect of those peculiarities. Two main features are meant here: 1) the specific cause of the Russian inflation and, 2) the specific structure of the Russian economy.

The reformers used the western concept of the causes for inflation considering it as a consequence of the surplus of financial resources. That's why they made a big error in forecasting its growth rates, because in Russian conditions the surplus of financial resources is one of the reasons of everlasting prices race, but far not the main one. The real locomotive of inflation is our Russian monopolism.

It embraces the whole economy, leaving only a small part of industry, agriculture and trade in the sphere of real competition. Together with self-isolation from the world market this is the most terrible heritage from past. There was no such a monopolism in history and no knowledge how to combat it all the more. The impotent antimonopolistic legislation couldn't solve the problem of breaking up enterprises and groups of enterprises into smaller units.

Monopolism being not a particular but an all-embracing phenomenon is capable of speeding up the inflation successfully. Financial stabilisation of the monopolistic economy alone can't stop inflation.

During the transition to stabilisation the prices growth gets its second wind, going on because of reduction of production and sales, this most dangerous way of the development of inflation took place when prices were liberalised.

The said above completely explains the dynamics of prices growth in 1992. The financial infusion turned out to be inevitable and inflation turned out to be the only alternative to the full paralysis of economy.

It's impossible to overcome Russian post-totalitarian inflation and at the same time the chaos in the national economy without control over monopolists' decisions in raising prices and reducing of production. But it is absolutely impossible to establish centralized price control, and establishing it will indicate the end of reform. The only

alternative that can control the monopolists is open to the world market economy. This means that domestic have to converge to world ones.

Is it possible for our underdeveloped and material consuming national economy to exist under the world prices?

There is an opinion spreaded that it is impossible because of uncompetitiveness and unprofitability of manufacturing industry and, first of all, of its core manufacturing industry. This conclusion is confirmed by numerous calculations including ones that used input-output tables. But there is one important point which usually missed by economists. Such calculations are based usually on domestic prices, acting tax system and basic rates of so-called selffinancing, which are established in sectors and groups of enterprises. An analyst enters at once into the enchanted kingdom of curved mirrors where reasons and consequences are mixed and imaginary efficiency is regarded as reality. Such calculations have been done in CEMI in proper time. And, naturally, for the above mentioned reasons they haven't returned any substantially new results. For example, these calculations were used to evaluate price growth in national economy as a function of price increase of fuel, to determine the sectoral structure change because of transfer to one or another pricing model etc. But the main problem namely evaluation of the real efficiency of the Russian economy is left out of these calculations. And only recently and, actually, for the first time, the calculations in world prices were done in the CEMI. And authors based their calculations not on the concrete ruble exchange rate but on the price structure. In world prices fuels, raw materials and food are relatively more expensive. Vice versa machinery "costs" less etc. These calculations results are shown in the Table 1.

Table 1

Parameteres of profitability (non-profitability) of branches in domestic and world prices

NN Branches and groups of : branches	Profit	
	(bln. rubles)	(bln. \$US)
1. Iron and nonferrous metallurgy	11.182	12.0 - 17.0
2. Fuels and energy sector	23.018	125.0 - 130.0
3. Machinery and metallworking	47.607	5.0 - 15.0
4. Chemicals and forestry	16.338	8.0 - 12.0
5. Light industry	19.632	-5.0 - -2.0
6. Food industry	3.790	2.0 - 10.0
7. Industries N.E.C.	2.721	1.9 - 2.1
8. Agriculture	27.193	-20.0 - -14.0
9. Construction	16.805	15.2 - 15.8
10. Services for material production	25.762	22.0 - 23.0
Totals:	194.098	166.1 - 208.9

The first column contains data on Russia for 1991 in rubles. The next column shows profit which could be received in the same year had the transition to the world prices (in \$US) happened. This column is a result of the analysis of a few most typical scenarios, calculated using input-output tables.

Table 1 allows to make three very important conclusions: 1) widely spreaded opinion about inefficiency of the Russian economy is refuted. The Russian national economy works with good profit not only in rubles but in dollars as well.

2) the idea about the sources of profit is changed radically. Around 70% of the profit of the national economy is made in the fuel and energy sector. This sector is the main source of enlarged reproduction and currently pays for non-efficient sectors of the economy.

3) the third conclusion is associated with the problem of the profit redistribution by the national economy sectors. Up to now this problem was solved using the artificially elaborated system of prices coupled with only labour component of value. Because of lowered prices of fuels and raw materials and relatively high prices of manufacturing industries production the profit being received for account of the rent of natural resources was "spreaded" among all sectors forming an illusion of their prosperity and profitability. The distorted mirror of efficiency has led to incorrect, alienated from real life management decisions.

The situation may be corrected if we stay on the real land of our Russian reality.

4. Strategic policy of reforms

Russian economy has at it's disposal great amounts of fuel and energy resources, mineral resources, fat lands and other natural treasures. The Russian resource potential per capita is 2-2.5 times greater than the resource potential of North America, 6 times greater than the potential of Germany and 18-20 times greater than the potential of Japan. In spite of barbarian squandering of this potential it's power is still quite enough to bring Russia to the leading level.

Russia has numerous skilled experts, who are capable of solving the most complicated problems of science, technology and production. The high intellectual potential of Russian science is recognized over all the world.

Also, Russia has a powerful technological production basis, which does not yield in a number of aspects to the technological basis of the leading Western countries including the USA. The parity of Russia and USA defense power that had existed until recent times confirms this statement.

Thus, the Russia has three main resources, which form necessary conditions not only for survival but for stable development as well. Will the Russian economic potential serve the prospering of the society or will it be spent on payments for other economic experiments? This is a question.

Everything depends on the policy being selected. Unfortunately there are too many maps which are layed on the navigator's table, and the location of shallows and the paths around them differ from map to map. Two approaches meet here: "from achieved" and "from possible".

In the first case successes and failures are measured with the existing miserable state of economy taken the origin. The situation when some steps lead the national economy to the crisis of non-payments and the following titanic work on solving this crisis is presented as a great success, may be an illustration.

The approach "from possible" is an orientation on the Russian economic potential which is quite enough for reaching a high level of well-being for many strata of the society. This approach allows to translate the purposes of our economic reforms into a criteria, understandable for everybody, which should make it possible to estimate the success of reforms in Russia, justify the reformers' efforts.

The first criteria is the level of social security and support of population, at least of these strata, for which it is most difficult to adapt to new conditions. Transformation policy shouldn't go out of permissible (approved by the population in evident form beforehand) limits of production decline, standard of living reduction, growth of social tense if the measures aren't proposed (aren't found), which would allow to avoid these negative phenomena.

Restrictions of this sort were used in the calculations which results are presented in Table 1. The wage rate in world prices was calculated based on the assumption that the consumer's basket which our soviet citizen has had in 1989 should be kept intact.

The second criteria is the use of the economy's resource potential. If due to reform the input of resources per unit of final product is not reduced or even grows this means that short-term goals of production stabilisation are achieved at the expense of complication of the long-term problems of rising the efficiency.

If we review the previous year from these positions then it is obvious that the mechanism that grinds resources is not stopped; actually it has increased its speed, because production decline outstrips reduction of consumption of raw materials and energy. The pride of power and gas who managed to maintain the the level of production is understandable but at present this means that efficiency of using resources continues to fall down. Last year approximately 1.2 times more energy per unit of industrial production was spent compared to 1990. Hence there are less possibilities of solving the problem of the standard of living. So, in both long-term and short-term aspects reforms haven't affected production efficiency rise. The Russian economy bears the reformers' experiments a great deal thanks to natural resources. That's why the problem of the necessary for reforms newest and resource saving technologies should be regarded as very urgent.

Third criteria is associated with investment activity. We are talking here about such macroeconomic parameters as the share of savings in national income, volume of replacement of the active part of capital stock, share of investment in the housing construction in total income of the population etc. Considering the tendencies resulting from reformers' efforts we can note that the share of accumulation will reduce to beyond the critical mark by 1995. It will be 3 to 5%. This is a full degradation of the economy. Achievement of normal proportions between savings and consumption even if the active measures on stabilisation of the economy and restructuring take place will require decades. The other criteria are in the same situation.

All said above emphasizes that the new strategic policy of reform is required..

The main points of this policy are the following: - new price policy;

- tax reform;
- monetary-credit policy;
- new foreign trade policy;
- efficient industrial policy;
- socio-psychological factors which support reforms.

All these elements of the new strategic policy are regarded together, forming the complex of mutually coordinated and mutually complementary measures. With snatching out one thing and proclaiming a struggle with this evil of "any cost", it's impossible to achieve a positive result, taking the country out of crisis. Complex approach is possible to implement because of a single plan that unites all the system of measures. It may be formulated in the following way: transition to the open economy. This doesn't mean "opening all doors without any constraints", free access to our market of foreign capital and commodities. Not only our sick economy wouldn't endure

it but any western economy as well. The different thing is suggested: to restructure the price policy, tax and financial-credit systems, custom tariffs and rules, policy of privatization and issuing of shares so that, on one hand, our monopolists feel the breathing of real competitors constantly, and, on other hand, the priority directions of industrial development receive efficient state support.

This should be the basis of elaboration of the strategic policy of economic reforms. As we will to show below, this is the most efficient way to solve all problems that have been accumulated.

5. Price policy

The main idea is adjusting the structure of domestic prices to the structure of world prices.

Using the present prices we can't evaluate properly the efficiency of investment projects, select the progressive directions for scientific and technological development, carry out efficient industrial policy. Prices are the main obstacle on the way of the foreign relations arrangement profitable for Russia. The trouble is that the existing difference in prices is measured not in percents but in times and is the main factor of formation of the predatory ruble exchange rate. Such exchange rate doesn't reflect the real purchasing power of ruble. This rate is the result of disproportions between prices of fuels and production of manufacturing industries, between prices of machinery and equipment and agricultural production etc. This allows enrichment of Western countries at Russian expense, illegal activities of numerous commercial firms which have foreign trade permissions, to increase of inflation and decline of production.

To stop these fatal phenomena for economy processes it's necessary to start price competition. This can only happen when an open type economy is being built. Then real restrictions for price growth will appear, the prices of similar foreign products will become these restrictions. With many opportunities available to choose from the consumer will estimate utility, quality and price of product, his choice expressing his preferences among domestic and foreign producers. This will certainly intensify competition and improve our economy. This mechanism, especially at the beginning, should be introduced differentially. It should be controlled by the antimonopoly committee, which should make decisions on opening those sectors of economy which have been negatively affected by monopolism. At the same time the state should exercise protectional policy towards perspective manufactures and support the sectors and regions, where specialization of production has to be changed for one or another reason. All these problems should be solved in frames of united price and tax manoeuvre. When solving the problem of adjusting domestic and world prices it is important to determine the group of commodities which would start the transfer to the new price policy. The importance of this approach is clearly shown by the present practice of price liberalisation. Although it is obvious that the prices for fuels should be released, since it forms up to the half of the Russian export potential, the price liberalisation affected these prices much less than the prices of other goods. As a result the price liberalisation doesn't lead to changes in price ratios, to increase of the prices of fuels and other natural resources prices compared to the prices for the production of manufacturing industry.

It is known that during last fifteen years up to 1991 fuel prices were fixed by the state at level tens and hundreds times less the world prices, 2.5-3 times less their marginal inputs, that is the real cost of increase in the production of fuels. This gap was compensated by free state investments in fuel and energy sectors and didn't

restrain growth of the production of fuel resources production. But this gap made economically unjustified most of energy saving measures and technologies, even the superfluous ones based on the world fuel prices. This was a latent reason of failures in rising the energy efficiency of the Russian national economy.

At the beginning of 1991 the government has decided to decrease this gap and rose the fuel prices by 100% in average, reducing the centralized investment into the energy-fuel sector. A few months later the level of prices of other products has grown 3-3.5 times making fuel prices 4-5 times lower compared to other prices. This made inefficient practically all energy preservation measures that require purchasing materials and equipment.

In January 1992 the state fuels prices were increased 5-7 times but during February and March the rest of prices grew 8.5-9.5 times. As a result the lagging of fuels prices from the rest of the prices increased 7 times, making economically absurd not only energy preservation, but production of fuels itself, because these prices didn't compensate even the maintenance cost of most fuel and energy enterprises.

In May 1992 the state fuel prices were risen 6 times again, the rest of prices rose less than twice. As a result the gap between fuel and other prices was reduced sharply and became 2.5-multiple, i.e. it was returned to the level before the beginning of 1991 when many relatively efficient energy saving measures were unprofitable because of the price distortion. Because of the sharp rise of rolled metal, machinery and equipment oil became unprofitable again by July of the previous year. The President has issued a decree in September concerning the oil and oil products price regulation. The prices are not fixed now, they are determined by the agreement with producers of oil products. But the litigation on the establishment of acceptable prices goes on so far. At the same time the 25% excise tax was introduced. Only lately the situation has begun to improve. But this process was stopped because of liberalization of fuel prices which was not accompanied by synchronous change of other components of the economic mechanism, especially taxes.

Meanwhile the calculations confirm that with such "sharp" price manoeuvre Russia will not perish as it was predicted by supporters of closed economy. Russia is in good condition for survival and, moreover for quick and efficient development on new structural basis. The first result will be stabilisation of ruble exchange rate. In this case it will be determined not by the marginal commodity price (the most expensive according to the present exchange rate) which is "worldwide popular consumer's commodities" but by all commodities average price.

6. Tax reform

The main idea is the rise of the state property incomes withdrawn into the budget, first of all of the rental payments from natural resources (from the bowels of the earth), with reducing all other withdrawals from incomes of enterprises and citizens.

Using all natural resources, minerals, land and water should be taxed. The calculations confirm that the rental payment for production of oil and gas alone in world prices only could amount to about the 30 bln. dollars of budget income annually (Table 2).

When the taxation system is properly organized, the total income that the state receives from the natural resources exploiting sectors is sufficient to pay for all budget needs and to contribute the pension fund. Therefore it should be possible to abolish the value-added tax, to reduce the profit tax, to free enterprises from contributions to the pension fund and to free the most of employee from the income tax.

Rental payments of the oil and gas group of enterprises*

Table 2

Years	Oil				Gas				Total rent bln. \$US	% of gas
	Extrac tion		Rent per unit (\$/ton)	Total rent bln.\$	Extrac tion		Rent per unit (\$/ton)	Total rent bln.\$		
	mln tons	%			mln. tons	%				
1992	374	100	34.8	13.0	559	100	40.2	22.5	35.5	63
1993	329	88	27.6	9.1	575	103	40.4	23.2	32.3	72
1994	315	84	20.8	6.5	591	106	40.6	24.5	30.5	79
1995	306	82	14.2	4.3	608.3	109	40.8	24.8	29.1	85

This allows to form grounds for breaking the vicious circle of collapsing price growth because of the fuels prices rise. New taxation system allows to maintain the total industrial products price index at the same level after the transition to the world prices in fuel and energy sector. The proportions of prices will change to adjust to the world prices, i.e. what should be done would happen.

The idea of providing a significant part of budget revenue itself is transparent and is used widely in world practice but, naturally, requires a special mechanism of realization and, therefore, legislation. At the same time it is much simpler technically than collecting progressive taxes from population (about 100 mln. citizens with several income sources each) and other taxes which have to be collected from hundreds of thousands of legal entities. On the contrary the rental payments would have to be collected from a limited number of enterprises and groups of enterprises of in. In Russian fuel and energy group of enterprises these payments should be collected from no more than 100 gas and oil extracting groups of enterprises. It's not difficult to establish an administrative and financial inspection of these enterprises which would guarantee the stability of the largest part of the federal and regional budgets income.

Selection of the correct form of collecting the rent is of big significance. For example, using royalty as a pay per ton of extracted resource for this purpose stimulates reducing of its extraction and is used to prevent the overproduction crisis or for carrying out the national resources preservation policy. Obviously, under the circumstances of a sharp decline in oil extraction, stagnation and the "laid aside" gas extraction decline using this form of rental payments is undesirable.

Perhaps, the fixed payment for the right of exploitation of an efficient deposit would be the correct form of collecting rent. This sum should be collected independently of the annual extraction level stimulating this way its growth or stability at sufficient level at least. These calculations should be based on the ruble's currency equivalent.

The problem of the rental payments collected from the mineral resource exploiting sectors distribution between federal, regional and local budgets should be solved considering not only economical, but political and social factors as well. Notice that

*The calculations were done in the Scientific and Research Institute of the Energetics Problems of the RAS under leadership of the RAS corresponding member A. Makarov

or product & rent markets.

establishing realistic rates of land tax is possible only upon development of the land market.

From the social and political point of view, the very idea of economic separatism expressed in attempts of local authorities to control natural resources should be rejected. Economically, these resources are the property of all Russian people. This thesis should be included in the Constitution as one of the main conditions for statehood and development of Russian national economy. The rental payment from exploitation of natural resources should be used to the benefit of the whole society. A share of these payments should be left at the nature exploiting regions disposal for stimulation of raw materials, energy and fuel production costs lowering and solving social problems in these regions.

The subsidiary policy should be a direct consequence of the new taxation system. The role of subsidies is quite incomprehensible now, since they are paid to the sectors which should have maximum profits and pay maximum rent. The only effect of such subsidies is aggravation of the disproportions in our prices compared to the world prices, putting our country on the wrong way.

From our point of view the only enterprises to receive subsidies should be those which are not directly related to exploitation of natural resources. Thus, only manufacturing industry enterprises, and among them only those that have a clear perspective of development and improvement. We have mentioned above that the profit of the manufacturing industry is almost null now. But, this is true only in average, differences between enterprises may be significant and additional support besides cancellation of taxes may be required for many of them.

The first stage of this assistance may be state financing of maintenance of existing production facilities that would free the enterprises from depreciation deductions.

The second stage of support could be a temporary delivery of subsidies in limits of unemployment benefits. These steps would assist in lowering production costs, and rising the enterprises competitiveness. An enterprise should be declared as a bankrupt only if these financial support measures do not help.

General subsidiary mechanism should be defined more precisely regarding the problems of realization of the most important state programs of industrial development.

7. Monetary and credit system

The main idea is transforming money into one of the most important production regulators, the factor of rising production efficiency.

Nowdays money doesn't perform its two main functions, as of the medium of exchange and as of a unit of account. This is one of the reason for inflation. The process of transferring money between consumers and suppliers is unacceptably slow, money constantly "stick" at different stages of financial documents preparation. A bank as the main link which should move on money through the reproduction chain works in the opposite direction now, using all possibilities to increase its profit. Bank in essence doesn't take any responsibility for violation of normal terms of transferring funds from consumer to supplier. Meanwhile the loss from bank's unsatisfactory activity are measured by hundreds of billions rubles now.

The first thing which should be done urgently is to introduce a mechanism of bank's responsibility for performing its main function namely ensuring quick turnover of revenues from production of important national economic outputs. This mechanism should be a part of the law on banking and work independently on whether the conditions of mutual responsibility between the bank and the enterprise were mentioned

in the contract. Similar responsibility should be provided in the bank system structure: between central, commercial and specialized banks.

The other important reason of inflation is the credit system. Under the circumstances of inflation it is very dangerous to issue

credits with low interest rate, which doesn't correspond to the fall of the ruble exchange rate. Such credits stimulate the most primitive financial speculations, not production. Taking a public credit in rubles it is possible to use it for buying hard currency, and sell it later. After repayment of credit and payment of interest large profit is left yet. This is a legal way to rob the state.

Interest rates for ruble credits should be greater than the ruble exchange rate decline (for example, by 1.1 which corresponds to 10% interest rates for currency credits). In this case it should be possible to reckon on expedient use of credits. And it is possible not to limit credit volumes because nobody will take a superfluous credit. From the other side any necessity in centralized settling of mutual debts of enterprises would fell away. So the bank interest rate would become the national economy financial stabilisation lever.

A bank's policy on the interest rates for deposits is unacceptable as well. Not only does the low interest rate for deposits depreciate population's savings, but it liquidates any interest in saving money in the bank. This is a direct robbery of population, which is possible only in an antidemocratic state. Moreover the negative interest rate for deposits is a powerfull factor of increasing inflation, it works against the state and society as a whole. Such policy suits only the state employee.

To fight this evil it is necessary to increase the interest rates for deposits sharply at least up to the level which would compensate the population's losses from inflation. That is why it is necessary to introduce monthly compensation on population's deposits with partial postponement of payments.

Monopolism of the bank structures is a great harm in the financial sphere. Its manifestations here are more serious than from monopolism in industry and other sectors of economy. That's why the first steps in the direction of opening the economy and attracting the competing western bank structures should be done in this sphere. Our financial monopolists will suffer from this action. But there is no doubt that industry and population will gain.

8. Industrial policy

The main idea is to stop the process of the deindustrialisation of the economy and reorient it's structure to resource preservation technologies and manufacturing with high value-added, leading to the expansion of the competitive industry sector which is capable of working efficiently for the final consumer.

From our point of view wrong ideas about the features of the post-totalitarian monopolism have leaded to absurd perspective decisions, to unsound industrial policy. The measures undertaken in the industrial sphere were most probably sporadic than systematic. They were not directing events but following them. When the selective approach is used, it often pursued political rather than economic goals.

The experience of 1992 shows that market reforms which are not supported by active structural policy may lead to a loss of the technological position, which Russia had at the world arena.

These circumstances make the industrial policy the first item of economic reforms.

8.1 Institutional transformations in the economy

The main idea is to form the efficient corporate sector of the industry management formation.

There are about 30 thousand of mid-size and small enterprises in Russia now and a few large ones like business concerns. The share of the latter is no more than 12% of total industrial production. In USA the 300-400 largest corporations determine the appearance of industry. They manufacture about 50% of all industrial production.

The stability which is so important for the market economy has been achieved when the corporative sector appeared. It happened not due to monetarism, but to another method borrowed from socialism, which is the planned control of production.

But unlike of our economy the capitalist economy "clipped" planning at the middle level. It is not used at the top (macroeconomic) and bottom (microeconomic) levels of management. The resulting construction is efficient enough. The corporations which accumulate large volumes of resources and products are working as peculiar transmitters of the macrosystem signals into the parameters of market regulation at the level of mid-size and small enterprises. The corporate branch of our industry has begun forming only in the late 80-es. But this process was stopped by the spontaneous liberalisation and privatisation. Reformers couldn't evaluate correctly its role and place in the management mechanism. They have seen only one side of these corporations, associated with primitive notion about monopolism. That's why they have missed the other side which is the possibility to form large industrial structures, capable to solve the problems of concording the market and planned management mechanisms in the market economy.

As a result the adopted path of the privatization of large industry was directed to forming of internal competition. For this sake the enterprises and groups of enterprises are divided, the technological chains are broken. This finally causes lowering production efficiency finally, and especially competitiveness at the world market.

In these conditions the pursued policy of accelerated privatisation is surprising. Most of the enterprises outlined for privatisation are capable of efficient functioning in the frames of larger organisational and technological formations. In the nearest future they will feel serious shortage of financial resources necessary for technological improvement, transition to output of new products, retraining personnel etc. The conflict is inevitable between "voucher" owners and those who has contributed the real money. Shortly, the privatised enterprises will be in fever for a long time. The world experience shows that ownership changes 3 to 4 times before the assets find their real proprietor.

It doesn't make sense to ignore the world experience forever. It is unacceptable that further Russian industrial development is based on the XIX century theory of market economy. It's necessary to build modern market economy. This means that an accent should be done on forming the corporate sector in Russian economy structure which is absent now. It is personified by large industrial corporations or financial-industrial groups (FIG). FIG's would have become powerful productional groups of enterprises, which could endure competition of the Western countries and provide necessary conditions for transition to the open economy.

FIG's can exert many-sided positive influence on the competition formation of a few competing groups in each of monopolised sector would mean a transition from supermonopolism to oligopolistic competition. This would allow to destroy the widespread at present tendency to form associations and holdings, which gather the enterprises of same type and recreate the previous sectoral monopolism.

FIG's would create the mechanisms of intersectoral redistribution of resources which are absent now. This would be favourable for intersectoral competition as well as for competition inside sectors. Competition between FIG's would make them interested in supporting small and mid-size collaborating enterprises technologically, financially, etc. Hence, the competition at the level of small and mid-size business would receive a powerful urge.

The FIG's would be willing to participate in realization of state programs. The chance will appear to allocate large state orders on really competitive basis. The possibilities for activation of the market mechanisms will be expanded by controlled admission of foreign competitors on the market.

Joining up of the technologically coupled enterprises, scientific and design organizations in frames of FIG's creates necessary conditions for coordinated technical and investment policy. FIG's are capable essentially improving the investment climate in our country, of decreasing the investment risks. Presence of a bank in group allows to respond quickly to the changes of industrial conjuncture and to redistribute financial resources. FIG's may become real centers of planning.

8.2 The mechanisms of providing support by State

The main idea is to use state economic regulation methods to exercise efficient structural policy, support manufacturing sectors which are important for Russian economy development, perspective researches and elaborations.

The mechanisms of the state regulation of market processes propose: - the strategy for selection the priorities of industrial policy;

- the mechanism for supporting and implementing the priority elements.

Stages

The system of priorities is elaborated by state structures (State Industrial Committee, Ministry of Foreign Economic Relations, Ministry of Economics), based on the goals of the economic reforms. Taking into consideration the real situation and the restricted possibilities, which the industry has for carrying out radical restructuring, the evolutionary priority system is necessary. It may be regarded as a three-stage strategy of development. It doesn't mean a switch of resource distribution when stages change but assumes some shift of priorities in time.

The main problem of the first stage (1993 - 1995) is increasing the country's investment ability using:

a) rational export policy, oriented on the development of large scale production of the products of primary processing of fuel-energy resources and raw materials.

b) economical conversion of the military-industrial group of enterprises. The latter, unlike "physical" conversion doesn't mean literal reorientation of the military-industrial group of enterprises on satisfaction of the population demand, but import of the demanded goods at the expense of export of arms.

c) using suitable mechanisms for transferring resources from low efficient and inefficient manufacturers to the manufacturers who would use these resources with maximum efficiency.

A very important goal of first stage is the maximum support of science, the most perspective researches and elaborations, prevention or maximum reduction of "the brain-drain". This requires direct budget support and flexible system of stimulus for commercial sector.

The "second stage" (1996 - 2000) goal is investment in resource preservation, that is transition of sectors and subsectors to resource preserving technologies and support of the falling down energy and fuel export at these expenses. Without such priorities it's doubtful that it would be possible to innovate the domestic machinebuilding, so that it would supply resource preserving technologies. The investments in machinebuilding without such priorities would multiply obsolete technologies, as it had happened in the second half of eighties and aggravating the economic situation. To improve the situation as a whole not with separate achievements in resource preservation using military industry for renovation of engineering industry is extremely important.

The third stage (2001 - 2015) goal is to use the created investment possibilities for mass production of equipment based on pioneer technology. This would solve the problem of Russia entering the group of technologically leading countries and staying in this group.

From the first stage goal follows that distributing resources between traditional and newest sectors it is rather impossible to be guided only by the criteria of the production perspectiveness (exports potential, efficiency norms growth tendency). It is important to support traditional manufactures which (1) restrain consumer goods import; (2) have high efficiency in world prices; (3) have a positive impact on other sectors, supply resources for the newest sectors in particular. Regarding these manufacturers it is necessary to take into consideration the indulating technical evolution of the world economy. If the national economy is properly integrated with the world economy, it can gain a lot. With proper integration it is possible to use the leading countries development hitches, splashes of demand for the basic sectors production, the niches which are opened in production of the components of the newest products.

Mechanisms for implementing priorities

Each priority element is implemented through suitable state programs. In addition to the goal section, each program has special section that describes the system of privileges and preferences, the exemption from taxes, favourable crediting, direct budget investments, investor support etc. Each state program is prepared by special governmental commission in the form of State order which is reviewed and adopted by the Parliament. The following item should be added to the federal budget: "Financing of the most important Russian state programs". The leading executor of the State order is usually determined on the basis of competition, and the leader of the state program is assigned the post of the Russian Government Deputy Chairman. One of the powerful stimulus for attracting non-budget investments in the state programs of industrial development is using some of state property which doesn't take part in the national economy turnover. We are talking here about congealed building sites, deposits of minerals, which are not exploited, land and forest resources and so on. Most of them are very attractive bait for both domestic commercial and western investors, i.e. the stimulus which is able to create considerably large flow of investments in implementation of the most important scientific and technological programs according to the priority directions of scientific and technical development.

Attempts to finance this sort of programs from state budget, happening now, probably, wouldn't succeed, because the efficiency of using budget subsidies is traditionally extremely low in Russian economy. Permanent deficit of the state budget and resulting efforts on increasing its revenues by "rigid" taxation obviously don't make investments more attractive.

That's why attraction of private investments should become one of the most important methods of implementing the industrial policy priority programs.

To solve the problem of attracting funds of domestic and foreign commercial structures giving them taxation, credit, customs and other privileges seems insufficient and inefficient. There is a more powerful stimulus, which is the state property that can be used as payments for achieving predefined results in implementing state priority programs. In this case the total financing (and associated with this risk) on implementation of the programs is laid on commercial structures and final payment for borrowed capital is done by the state according to the achieved results.

To accomplish certain programs of the industrial policy it is necessary to form separate specialized funds for supporting separate programs. These specialized funds should carry out following functions: to accumulate finances; to do current financing of programs; to do trust management of both the state property, used for implementation of programs, and all privileges and preferences given to these programs participants.

This approach should determine the attitude towards the state property which is not exploited, allowing to reduce the strain of the state budget essentially, providing necessary financial flow for the most important Russian development programs with simultaneous distraction of the commercial structures "hot" money from the consumer market and, hence, with reducing inflation pressure.

The problem of the military-industrial group of enterprises conversion should be solved in frames of the adopted program-oriented approach.