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A PLAN FOR RUSSIA

So far the market reforms in Russia not only failed to bring the expected results, but also deepened the crisis of the entire economy. The level of production and living standards continues to decline, and the social costs and foreign debt are increasing, though the opposite was expected. It is still possible to reverse the process, but it requires a correct approach to reforms that does not mix the goals with the means. It is necessary to combine the policies of systematic transition with the development policies, most importantly by juxtaposing internal and external mechanisms of transformation. The situation calls for a new “Plan for Russia” consisting of 15 main points.

Part One: Russia – for itself.

1. The fight with organized crime and absorption of the “shadow” economy.

There is a need for radical action, as corruption and organized crime groups oppose reforms and continue to counteract its results. Organized crime must be fought with the sound co-operation of international partners and full political commitment of the government. With respect to the “shadow” economy, this form of economic activity should be absorbed, and not eliminated, for the benefit of the development of free enterprises and future growth of production. For this purpose, shadow economy must be gradually, calmly, but decisively integrated into the legal economy. It calls for fiscal measures and institutional streamlining.

2. Financial stabilization and protection of the ruble.

It is necessary to accomplish a primary budget surplus (i. e. not taking into account expenditures for debt service) and it must be achieved not but further cuts of budgetary expenditure, but through widening the taxation basis. The final fiscal deficit can be financed to some extent by a relatively low level of monetization. The IMF ought to provide the next tranche of agreed credits to support the budget. The currency exchange rate should be

managed is a way promoting both anti-inflationary policy and the growth of exports. For this purpose the best mechanism will be a crawling band, allowing for gradual, though predictable devaluation. International organizations must support such policies, but only under the condition of introducing further structural reforms. Without these reforms stabilization will be unattainable as much as it will be impossible without backing by the IMF.

3. The reform of the public finances system.

Russia needs a taxation system that would reflect the existing administrative structure of the country. The system should strengthen the financial position of all branches of the federation in the governmental administrative structure. At the same time, it should limit the prerogatives of the central government in favor of increasing prerogatives of the local governments. There is a need for gradual and consistent transfer to the lower levels of government of the responsibilities for the development of educational system, healthcare, as well as funding allocation. Currently, there is an extremely high level of reallocation and centralization of budget resources. This is also true on the mezo-level. The budget system must promote the development of a public services sector and be freed from the responsibility to directly support outdated and noncompetitive enterprises.

4. Rapid development of small enterprises, especially in construction, services and infrastructure of agricultural sector.

This requires a well designed regulatory system, a simple judicial mechanism, and both institutional and financial support of government. Governmental support should flow through a system of credits for certain goals and a flexible system of taxation. Government agencies must organize technical support for small and medium size companies. The World Bank should provide financial support for the process using the experience and work of experts from countries presently implementing programs of structural reforms, including countries in transition to the market system.

5. Gradual and irreversible restructuring of large enterprises and outdated industrial sectors.

This necessitates the availability of financial resources, including foreign strategic investors and, later, privatization with the use of foreign capital, including capital from other transitional countries too. Full commercialization of the state sector enterprises will improve the corporate governance and competitiveness of Russian companies. Commercialization must be comprehensively introduced before privatization. An attempt aiming at improvement of already de-nationalized companies must be taken too. Privatization is not sufficient for upgrading allocative efficiency and must be followed up by the government competition policy.

6. Self-sufficiency in food supply based on private sector production; changes of the underlying nature of the laws to promote market relations.

Crucial for counteraction current crisis and future development is the overhauling of agriculture and food processing industry. Russia must urgently be ready to feed its own people without import of food. Key factors with this respect are the development of a food processing industry, storage facilities, transportation and distribution system. To accomplish this goal, technical support from the UN Food and Agriculture agency (FAO) and the financial support of the World Bank are needed. This will lead Russia to become self-sufficient in food production in the next three to five years. This is a very important, since about 60 per cent of the Russian household income is spent on food.

7. Changing the course of policy of external economic relations.

The growth of exports must take place in the more competitive sectors. First of all, industrial policy must help to restructure the manufacturing and processing industry sectors that refine the raw materials excavated in Russia. In the future, there must be a decline in the proportional weight in the country's payment balance in raw materials, including energy resources, and increase in proportional weight of the manufacturing industry. Simultaneously, the policies in this area must promote the development of exports to the new markets. Further attempt must be undertaken to attract an inflow and efficiently absorb direct foreign investments, mainly geared toward export expansion. This requires appropriate changes in the laws in such areas as taxation, customs, and licensing, which will promote the influx of capital investments directed into the competitive industries. At least a third part of Russian industries has a chance to be competitive after restructuring, including the international partners, will be implemented.

8. Investments in human capital through improvement in skills advancement, education, health care, culture, etc.

Even though Russia has a relatively well-educated and trained work force, additional governmental investments and wise policies of the national and regional governments are necessary to maintain it. With the help of economic incentives, the outflow of highly qualified experts from the country must reduce. International community instead of brain draining must focus its political commitment and financial assistance on brain training.

9. Institutional support for the market economy.

The ongoing process of liberalization and privatization must receive support from a well-developed legal system and gradually forming market institutions. There is a need to review fundamentally the existing laws, not simply to enact short-term changes. This is especially important for to capital market, investment and commercial banks, export stimulation and capital investments in technical development. Without overhauling the current systemic vacuum neither plan, nor market system privatization itself will remain unable to improve the competitive edge.

The complexity of Russian transition in overcoming the recent crisis consists in achieving well-balanced development along with integration into the world economy. This requires immediate, well-coordinated participation of the international community. Foreign trade partners and investors, international economic and financial organizations, international corporations, research centers and foreign governments all have the opportunity to play significant – and creative - role. Their cooperation is required for the successful implementation of the main points of this Plan, even though Russia must execute most of it on its own.

Cooperation with Russia necessitates the following actions on behalf of the world community:

10. Financial stabilization requires the reduction of the large foreign debt.

Partial debt forgiveness is necessary. Even in the most optimistic assumptions for the future, Russia will never be able in full to repay its foreign debt. It will soon reach \$200 billion. Thus, a special program of debt forgiveness in exchange for reforms should be enacted, giving Russia a chance to climb out of its present economic crisis. As much as 80 per cent of the old debt inherited from the Soviet Union and 50 per cent of the remaining debt should be written off in a similar manner as in Poland, that is, on the strict condition that further market reforms continue. The fact that the Russian debt cannot be paid must be acknowledged now — when it is not yet too late — and must be restructured on behalf of both the Russian economy and international creditors. Without a managed program and wise policy approach, both sides will lose much more in the long run.

Additional part of the debt should be exchanged for equity in the country's privatized enterprises. For foreign creditors, the best way to receive a return on loans is to take a stake in the future profitability of Russia's assets. Such large swap of debt for equity would be international in scale and would require approval from all banks, organizations, and governments involved. This program must not be left to the sole supervision of the IMF, but should be managed by a special ad hoc international body called jointly by the G-7, the new Russian government and the World Bank.

11. Without further delay, leading industrial countries must admit Russia into the World Trade Organization.

Though Russia cannot yet meet all the criteria, a special case should be made for its acceptance to this organization. WTO membership would enable a gradual, feasible liberalization of Russia's trade into the world economy and would contribute to the overall globalization of trade and commerce. Russia's accession to WTO will help to put its economy on the track to the export-led growth quickly, which is as much in Russia's own interests as it is in the interest of its creditors, foreign investors, and trade partners world-wide.

12. It is necessary to design a special package of regional development programs with the support of the United Nations Development Program (UNDP).

This should help to raise capital within Russia's many regions and streamline the institutional framework for their development and integration with neighboring countries. The complex structure of the Russian Federation requires certain development issues to be solved on local and regional levels. For the economic integration of the Federation fundamental is decentralization of the design and implementation of development programs.

13. Upgrading Russia's infrastructure is important for national as well as regional development.

This can be achieved with the assistance of the European Bank for Reconstruction and Development, which must concentrate on these issues, leaving other activities to commercial and private banks. The EBRD should help to finance the improvement of Russia's decaying roads, telecommunications and Internet capabilities, and should not engage in the financial sector. The infrastructure program should be linked to regional development policy, furthering the need for greater cooperation between regions and neighboring countries. For this purpose, the countries-members of the EBRD, as the shareholder, must increase the capital of this institution.

14. The international community also must provide support to Russia in its attempt to alleviate poverty and to establish a viable social safety net.

The help should be offered, first of all, to the population living below the poverty line. The organization best prepared to assist Russia in meeting the challenge of containing the poverty is the World Bank. The World Bank should be treated as a separate entity from the IMF, prepared to work with Russia mainly on poverty reduction, not on numerous programs that disperse funds without further intervention. The World Bank must act disregarding the IMF opinions and by using its own evaluation of the needs and conditions that must be met before any assistance would make a sense.

15. Russia's long-term development depends on reforms in institutional and legal frameworks for investments.

The proper organization to help in this instance is the OECD, with its long-term approach and expertise in building sound investment institutions. The Russian crisis is not an emergency case, which could or can be solved by a bailout, but a long-term structural, institutional and political crisis that requires an overhaul of the institutions and structures to enable a productive system of investments to replace the current chaos. The OECD is capable of assisting the process of facilitating higher savings and thus capital formation (instead of capital flight), and its better allocation. These processes should help to attract more direct foreign investments.

The success of this 15-point “Plan for Russia” depends not only on the detail technical proposals and solution, some of which have been already successfully implemented, but also mainly on reaching a political consensus, which currently is absent both in Russia and on the international scene towards Russia. Without minimum political cooperation, even well developed economic programs will fail.

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