

The Present State of the Russian Economy

March 1998

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The aim of this paper

Some western observers of Russia seem to believe that having abandoned Communism, Russia must be proceeding along the road toward a democratic, stable market economy. This paper argues that this is not happening nor is it likely to happen.

Section One describes the Russian economy, starting with the reforms that were supposed to lead to a thriving market economy, but which mostly succeeded merely to put in place the trappings and fashionable aspects of a capitalist economy and financial system. The principal effect of the reforms was to bring manufacturing industry and much else almost to a halt and in so doing to impoverish the mass of the people. Economic policies and aspirations of the Government are inconsistent, not to say contradictory. Most of the critical aspects of the real economy have not been improved; these are discussed together with their negative effects on the people, the environment and ultimately on the stability of the country. Section Two attempts an explanation of why little or no credence can be given to the expressions of optimism, heard very frequently from her politicians over the past two or three years, that Russia is now on an upward economic path. This explanation begins with a broad brush historical review of the social and economic development of Great Britain during this century in order to provide readers with a familiar, and it is argued, a successful scenario to use as a datum line by which to compare and contrast the socio-economic legacy over the same century of contemporary Russia. In conclusion, it is argued that there is nothing in this legacy which compares with the forces at work in Britain and which would therefore stimulate or allow Russia to 'become anything like us'. Russia will remain trapped within its own peculiar, historical brand of arbitrarily determined chaos. It is not possible to predict its future except that the least likely path is one of approximation to our kind of economic, social and political order. It will be, as usual, the Russian people who will suffer and perhaps they will not be alone.

Introduction

'Give them time' cried the optimists but even the 'Economist', having largely ignored the lack of genuine success from the outset of the so-called reforms, removed its rose-tinted spectacles and asked: 'Is the Russian economy beginning to go wrong?' In its issue of 14th February 1998 under the title 'Russia's part-time president' it concedes that 'Russia has no economic policy' and at last perceives that 'Mr Yel'tsin seems to view declarations of intent as an acceptable substitute for action'. It has been thus from Potemkin's Villages to today. Economically speaking the progression from the dogmatic Soviet rigidities to the inchoate fumbling of Yel'tsin's rapidly changing cast of Presidential advisors and Ministers, hardly provides evidence for a belief in positive evolution. In Russia one has to modify Darwin's statement to 'Survival of the Fattest'. They are still adding to their personal wealth, to the contents of myriad decrees, orders and laws, they continue to stir the same mixtures after 10 years of a lack of a strategy or a coherent policy. Ministerial statements always promise 'jam tomorrow, never jam today'. They rarely return to see if their promises

have been made good. But to an observer with an analytical bent it seems that jam does exist, but only as a log jam consisting of chaos created by muddle-headed decrees, laws and regulations created by Institutions of Government which are at loggerheads with each other. This paralyses the system and prevents consistent improvement in the economy.

Even President Yel'tsin agrees that the economy is in a mess; periodically he issues statements criticising his Government for failing to improve it, proceeds to demean his ministers and even sack them. From the latest sackings in March 1998, it would appear that he has no more idea how to improve matters than they do.

What is the state of the economy?

This is not easy to determine since the answer partly depends on the viewpoint of the respondent and the criteria he adopts. One could take the view of the financier and potential investor whose aims are to use the financial mechanisms, not in order to invest in the economy of a country and thereby to earn a capital gain and return on capital invested, but to speculate in the money market with the aim of a quick gain. From that point of view Russia indeed has some attractions, more from the opportunities taken by Russians and their contemporaries in other successor republics to the USSR, than to westerners who can make money by taking much care and advice in an extremely risky market. The picture looks very different to those whose criteria are characterised by measuring the state of the base of an economy and its consequences on the life of the ordinary people. From the base, there seems to be little benefit from the government or from the manipulations of financial operations. These are almost totally different worlds. Let us start at the level of macro-economics and work down to realities.

The Central Bank sets the re-financing rate. This has varied, over the past few years, between 200% and 20% per annum. On 28th January 1998 it was raised to 42%, which inhibits capital investment through borrowing money and also makes it harder to finance the 1998 budget because higher interest rates result in the Government paying more for its short-term borrowing on Government bonds (GKOs). An extra 25 Bn New Roubles (NR) has been set aside. Servicing the State debt, according to Zadornov, the Finance Minister, is expected to absorb 20-22% of the Federal Budget. In 1997 this took 18%. Economic activity will also decline and hence tax receipts. After Jan 1998 there will be no time limits on foreign investment in GKOs, which have a high rate of return but are subject to a special exchange rate for the ruble against hard currency; this restricts repatriated profits to some degree. Foreigners currently invest \$700-1000 Bn every month, accounting for 15% of the market. This share is expected to rise with the lifting of restrictions. However, the Central Bank wishes to discourage foreign speculation in GKOs; it has in mind the 1994 collapse of the Mexican debt market which heavily depended on foreign investment. In a contradictory move to the lifting of time restrictions, it will set a quota for foreign investments in GKOs¹.

Apart from holdings of GKOs, because the exchange rate of the ruble has been, since July 1995, pegged within a corridor of gradually crawling deterioration against the major foreign currencies, it has been possible for Russians and foreigners to deposit roubles, take them out again after 6 or 12 months and gain about 8-10 times the interest that is available in stable western currencies and then exchange the roubles with around a 9% loss compared with the initial rate. This has attracted 'hot foreign money' as well as that of some of the Russian population. Gains are immediately

exported; they may or may not have paid tax; this depends on 'blat' - whom you know and who can fix it. Strangely enough, the Russian Central Bank does nothing to prevent this outflow of money and capital; it seems to regard the foreign money as having a bad effect on the internal money market. A recent comment in the Russian 'Finansovyye Izvestiya'² points out that the high interest rate represents the risk perceived by the investors. The same paper observes, without explanation, that it would be better for Russia if this hot money did not participate; partly, it is to be imagined, because the profits earned are withdrawn from the Federal Budget and therefore the economy which sooner or later will have to make up these losses. None of this money benefits the economy since it is not invested by the banks, who also speculate with it, or by the recipients. The flight abroad of money has been phenomenal; successive Finance Ministers have made their own estimates. Fedorov, when he was Finance Minister gave it as \$200 billion and one of his successors stated that a further \$50 Bn have been added since; this is in line with some western estimates.³ 'What is sure is that the outflow, in addition to diverting funds required for domestic investment, means the government receives no taxes on it.'⁴ On February 1st 1998 hard currency reserves, used to back the ruble, were down to \$18 Bn; a loss of \$6Bn in just one month. Another Russian economist⁵ stated recently that Russians are also hoarding around \$70 Bn not deposited or invested in any financial institution. He observed that if this were made available it would more than pay for the much needed investment in the basics of the economy. However no one trusts the banks and there is no reason to believe that any such funds would end up where they would benefit the country rather than some highly placed officials.

The State Committee on Statistics (Goskomstat) published figures for 1996 showing that household expenditures included the purchase of considerable amounts of foreign currency. The figure rose regularly from 13.5% of their total expenditure in January to 21.7% in December and is still rising. Plainly, in spite of the government's wishes and decrees against the use of foreign currency for internal trading, the population still regards it, particularly the dollar and deutschmark, as a useful precaution. All one needs to do is to change it at a money booth and pay in roubles for current purchases. This fact suggests that the low level of purchases of consumer goods made in Russian factories is not due to lack of money; that part of the population that can do so prefers to save rather than spend.

Soon after the collapse of the USSR, roubles became legally convertible within the country, and shortly afterwards it also became legal to export hard currency. The Russian press has been full of examples of purchases of land and property in desirable places abroad. These places include London, New York, Bermuda, Spain and Cyprus as well as the Arab Middle East. The New Russians, as the seriously rich are called, have acquired wealth rapidly in various ways which would be condemned in the West, at least in law. Their operations in tax havens seriously worry western Treasuries because of their effect on our money markets, especially in laundering money.

This outflow of money occurs simultaneously with requests by Russia for large loans from the international and national financial institutions. Their loans and credits amount to around £6Bn. These are used to pay Government debts on current account, not for investment in projects that would revive the economy, earn a profit and thus repay the loans and credits. It is beyond belief that Russia will ever repay the credits and loans advanced; they are constantly being rescheduled. The loans should be unnecessary if the Russian Government had put its financial and economic house in order. Some commentators argue that Western loans are simply encouraging profligacy. As we shall argue below, the Russian leadership is incapable of, and indeed

unwilling to, take the steps that would lead to a genuine improvement in the economy.

Foreign investment

Foreign investment in the genuine economy is vital but is unfortunately not large. Chernomyrdin hoped for \$6Bn in 1997 and for a total of \$20Bn by the end of the century⁶. One has to compare optimistic statements by Ministers and other economic commentators with facts. These show that foreign capital investment in Russia is below that of some other, much smaller, central and east European countries. It is not easy to determine a fact in Russia; even the same Minister is prone to giving widely differing figures. The best that the objective observer in search of truth can do is to provide a probable range. Chernomyrdin reported:

"In 1994 foreign investment was only \$2Bn; in 1996, \$2.8Bn and the total to the end of 1996 was \$8.5 Bn. Investors rank Russia as 200th in a league table of desirable countries for investment."

Other issues of the same paper gave even lower figures: Foreign investment in 1994 was given in December 1995⁷ as \$1.0 Bn. It was, furthermore, very unevenly distributed; half went into energy companies, only 4.1% into engineering. Some regions benefited considerably whilst others not at all.

Foreign investing countries are reported⁸ to be USA 29.1%; EU 32.7%; Switzerland 15%. The EU additionally gave Russia ECU 1.5 Bn over 1991-95.

The Stock Exchange

A stock exchange was set up; such an institution, plainly is an essential element of capitalism and therefore Russia had to have one, even if it was impossible to value a share in a manufacturing company. There are, as yet, no proper means of valuing land⁹, industrial buildings, equipment, other fixed assets, profits, or indeed income and expenditure, reserves for contingencies, creditors and debtors, costs of production or any elements essential to financial assessment and prognosis. It is noticeable that wise western audit firms often state that their audit of firms in fSU, including the Baltic Republics, is based on the statements of the directors, ie the convenient fiction of the moment.

Commodity exchanges

Shortly after the collapse of the USSR; commodity exchanges also appeared. Since London had the respected Metal and other Exchanges, no self-respecting capitalist country could do without such organisations. Obviously they performed the key roles in buying and selling. Even highly intelligent people think so.¹⁰ So Russia had to have them. They performed none of the proper functions of, say, the London Metal Exchange. These were attempts at creating cartels to control the price of Russian raw materials. All they managed to do in reality was to flood the world market with, for example, aluminium and titanium in a stampede to get rich quick. The inevitable result was to drive the price down and hence the receipts to Russia. But these associations could afford offices, 'Presidents' and of course parties.¹¹ Of the 300 set up, only 9 were predicted to remain by the end of summer 1994. Many are bankrupt and owe billions. No further mention of them can be found in the Russian press.

Wages, prices and inflation

The arrival of Gaidar's reforms in 1992 ushered in galloping inflation in both prices of food and consumer goods. As a result food did appear in the shops but significant sections of the population were severely impoverished because wage rises not only lagged but were also raised non-uniformly. The savings of the populace were rendered valueless, people could no longer live on their pensions. At the same time industrial products used by farmers rose in price thus increasing the differential in Lenin's famous 'scissors', the widening gap between the cost to farmers of equipment and the prices set by the State for agricultural produce. The ruble began a runaway fall against major world currencies. Real incomes are now some 40% below those of 1990. Average per capita figures across the country in 1997 were R829,600 (\$150). But in many provinces the figure was around half that, with higher cost of basics partly due to the isolation of the areas. Official figures, presumably derived only from declared incomes, showed that in 1993¹²

- * The top 2% of the population received over 27% of the total income,
- * The top 10% received 63%,
- * The bottom 10% less than 5%,
- * The ratio between the top and bottom deciles of declared incomes was over 12:1 in 1993 and it got worse; in 1997 it was 12.8:1.

Matters may have improved somewhat since, but Goskomstat figures for 1996, derived from a household sample, showed: between 30-36% of the population, 20.2-24.2 million people, in 1996 lived below the official poverty line and 9-12.7 million, ie 6.4-8.6% of the population, could not afford to buy the minimum food basket. This varied across the country; the average cost across the country was 219,000 roubles/month and the subsistence level was 394,000 roubles/month, whilst the average pension was in July-Sept 1996, 310,700 roubles/month. Conditions in Moscow or St Petersburg do not reflect the life of ordinary people in the far countryside depths of Russia.¹³

Since Ministers at various times have estimated that the grey and black economy, neither of which declares its income or pays taxes, is responsible for between 30-50 % of GDP, plainly the real figures must show even more people earning much more and that the share of GDP of the rich is larger than stated.

From the beginning of the period when the ruble was freely traded against the dollar the change in the rate can be compared with the rise of internal prices and wages. It rose about 8600:1. Nominal average wages at the end of the soviet period were measured in hundreds of roubles per month, probably between 100 and 300. In Jan 1994 they were 134,161 roubles, in December 1996 1,017,000 and in January 1997 870,000, ie somewhere between 3000 and 10,000 to 1. Since the corridor was set in place and since the official calculation of inflation began to be based on internal figures that rate has indeed come down. But the real rate for that portion of the population living above subsistence level is much higher than that officially published, since it is calculated only on the limited basket of goods considered essential for subsistence living.

The Government claim credit for the reduction of inflation to present levels. It is arguable that this has been achieved as a consequence of the drastic reduction in demand and by the reduction in economic activity to very low levels.¹⁴

We may also observe two other financial factors:

- * the enormous debts of the state accumulated in unpaid wages to state employees, including the military. Government debts may amount to 25% of GDP. The pensions funds, together with funds earmarked to pay unemployment benefit have been raided and figure in what are called 'non-budgetary funds' which are used to pay current items including those other than for their intended purposes.

- * the circulation of pseudo-money, in the form of IOUs, for example to energy companies by State administrative organs as well as by nationalised industries and also by private persons. These IOUs are used in trade, heavily discounted, as if they are money.

Government income

The 1998 Federal budget intends to spend just under 500 billion NR, 17.7% of GDP; to raise NR 368 billion, keep inflation below 5.7% for the year. GDP is predicted to be NR2840Bn. The Government asserts that it could pay its debts if only it could collect the taxes due it. In 1997 it collected 611Bn NR for federal, regional and local governments; this was 98% of the target and 32% more than in 1996, according to Pochinok, the head of the tax service.¹⁵ Of that 267.2 bn was for the federal budget, 37% more than in 1996. He reported that only 55% was collected in cash. He did not say what the rest was paid in. It may be that taxes due were offset by debts owed to the enterprise by the government; this practice is now being debated in the Duma; the result may be that it will forbid the government to continue this practice. It is also possible that the Government will ignore the ban on offsets. VAT accounted for 48%, 21% from excise duties and 15% from corporation profits tax. Pochinok added that in 1998 the task would be to collect all taxes in cash. Deferments in tax due would not be tolerated. His target for 1998 was to collect NR265Bn - a surprising reduction on the previous year!

But these figures have to be compared with those produced by his colleague V. Popov the head of the department responsible for collecting tax arrears.¹⁶ The total amount owed to all levels of government is NR 554.9Bn, of which NR 297.9Bn is owed to the federal government. If these figures are true, the only way to reconcile them is to assume that arrears dated from before 1997. However Yel'tsin's economic adviser A. Livshits is doubtful if the tax collection reached anything like the claimed figures. According to Dr V. Shlykov¹⁷, a former deputy chairman of the State Committee on Defence and an expert on the military budget, the current tax code consists of 1200 'poorly coordinated or utterly contradictory presidential decrees, government orders and ministerial instructions, plus around another 3000 acts that refer to tax norms'. Businessmen and others complain that the tax system is chaotic, often punitive to honest business and therefore invites tax evasion.

As we note below, the Soviet economy was not based on money. Firms did not pay taxes; the State simply appropriated the 'profit' ie difference between the input costs as set by the State and output prices which were also set by the State; there were at different times varying amounts of retentions and bonuses allowed to the firm, but this did not alter the fact that firms were not accustomed to paying taxes as such. There was at some time in the soviet period, especially the last decades, a graduated income tax for individuals; but this was a very small part of total income and again, work done 'with the left hand', moonlighting, was never declared or assessed. People became adept at working for themselves outside the system, partly to get more money and partly because they were fulfilling a need which the State was unable to supply in a

manner satisfactory to the customer. This included dental work above the standard prescribed, private lessons, repair of cars etc.

The continuing non-payments of accounts due results not only in the use of IOUs¹⁸ but in the continuation of the old barter trade between soviet firms, republics, regions and also in foreign trade. This barter trade pays no tax, no VAT. How is it to be stopped? If Government Inspectors stand at the gates 24 hours a day, check goods inward and outward and check that flow against documents, they might be able to assess its worth. They would then have a job proving that the tax is due and getting a court order against the defaulter. Either the bureaucracy and/or bribery would frustrate the process.

Just as the putative tax payers were unfamiliar with taxation, so are the tax authorities in the reform period. They rushed into a tax code which was riddled with anomalies, created a load which prevents business run totally honestly and in accordance with the tax code to be profitable. Most variants demand as tax between 60-70% of the total income of a company, let alone profit. Some demand more than the total income of the firm. Consequently there is widespread tax evasion and late payment. A recent introduction is that of a special tax police. They are not specialists in financial matters, indeed some are retired army officers. Its head was a General. It is unlikely that such people will outwit criminals or determined tax evaders.¹⁹

Successful foreign businessmen say that the tax police descend on them, make life a misery and only go away when a bargain acceptable to both sides is struck after much misery and disruption of business. This is not unknown in some western countries for example Italy. No wonder that the press is full of complaints and that the Federal Council and Duma are constantly seeking revisions to faulty legislation.

The Government is supposed to be the beneficiary of Customs dues. But it also acts in a manner similar to that of Queen Elizabeth First of England. It awards tax privileges to its cronies. For example not long ago Yel'tsin gave the Minister of Sport the right to import tax free alcohol and tobacco. This must have ended up on the open market at huge profit to the Minister and his circle.

Sharing the income

The Federal Government is not the only organ of State in need of income. This is true for Republican, Oblast, Rayon and City authorities as well. In the past the Central Government and Central Committee of the CP doled out funds to these bodies; the shares were the result of much lobbying, cronyism etc. This is still the case with some differences. The lower organs have the job of collecting the taxes and transmitting the share due to the Central Government. But things are a bit different now in that the lower organs get it first. This gives them some leverage.

The economic health of the different regions in the Federation varies enormously. The basic resources, the degree to which they are being exploited and to whose benefit, the ability to fend for themselves or otherwise are significant factors in the economic stability of the Federation. Many regions are now inhabited by bankrupt organisations which derive very little income from their proper work. It is frequently stated in high government circles that about half of all commercial enterprises in the Federation are bankrupt, but few if any have been put into liquidation. Such firms are still responsible for paying their workers, and continuing to provide them with the social services to which they were accustomed. These include company owned flats, creches, hospitals, first aid clinics, canteens, subsidised shopping. That is why workers do not

leave, still appear on the books even though their pay may be months late. This partly explains the low official unemployment figures.

In practice Moscow City pays nearly 25% of the total income of the Federal Government and 60% is paid by only nine 'constituent parts of the Federation' according to Pochinok²⁰. Only 23 out of 89 regions contribute; the rest are a drain on the economy and the Federal budget.²¹ The Federal Government is in constant negotiation with the richer republics within the Federation, regions, etc. The viable republics and regions have become more powerful in their dealings with the centre; some feel that Moscow does nothing for them so they do their own deals in foreign trade. For example Sakha sells diamonds direct. The Federal Council, the upper house of parliament, represents the interests primarily of the regions and therefore is becoming more powerful than the Duma.

The problem of non payment of accounts due

As we saw above, the Soviet internal commercial system was basically one which did not require money to pass for transactions between commercial organisations or between them and the State. Trade was accounted for by book-keeping entries and much of it was done by barter. When the Soviet Union collapsed so did this system of central transfers of book entries. When it became clear that the State itself was bankrupt, the factories and collective farms etc did not stop work entirely or suddenly. The railways and other means of transport continued to function. This was a bit like the nervous reaction that propels a headless chicken to continue to run, that is if money is seen as an essential lubricant of trade. However, people brought up in a soviet system did not necessarily share that view; real life could function as it did before without money. Some factories continued to produce for want of anything better to do, the defence industries and many others simply made for stock, waiting for the State or other organisations to take the goods off their hands. When they ran out of components, they, as of old, paid the suppliers in goods²² or in IOUs. Even Gazprom admits that in 1997 it collected only 38% of payments for gas. But it also traded IOUs from customers. The factories had no cash with which to pay their work force; so they were reduced to paying workers in kind. This process has expanded considerably to the present day. It must be tough for workers in factories that make things that are harder to sell.

Barter trade between enterprises and even governments is common. Much import carried out under barter consists of raw materials. Lukashenko, President of Belarus, spends much of his time fixing and signing barter deals with his opposite numbers in Kazakhstan, Uzbekistan and others within the Russian federation such as Siberia. Barter trade, of course, avoids paying taxes, especially VAT. A recent report²³ estimates that 80% of Russian firms are involved in barter trading. The author suggests ways for foreign firms with Russian partners to monitor this trade, which can cost them dear.

On the one hand the State loses from barter trade but on the other it gains, from non-payment of accounts, since as a major debtor it pays late with devalued money. Debtors can hold on to money, which they invest, earning high interest rates, as we have seen above. So it is on balance probably beneficial to the main debtors, such as the state, in all its forms, banks and commercial houses to continue with the present methods of trading. As at 1-1-98, it was reported²⁴, companies in industry, agriculture, transport and construction owed 782,200 Bn old roubles (about \$130 Bn). Until the economy is running normally, with goods bought and sold through the normal mechanisms of a market economy, on a regular basis of confidence in prices

and payment, it is unlikely that a conventional monetary system will come about. There is much discussion by government, which claims it is determined to solve the issue; it is setting up special commissions and study groups to solve the problem. No progress is made. It is not in the interests of the debtors to solve the problem of non-payments of debts. Since the Government²⁵ and the banks amongst other commercial houses are the main debtors, and have close connexions with senior politicians, it would seem unlikely that the talk about solving this problem will be translated to effective action.

Privatisation and Corruption

Finansovyye Izvestiya²⁶ gave the following analysis of small business activity at the end of 1995.

1	Construction	31%
2	Industry	28%
3	Foodstuffs	25%
4	Others	10%
5	General commerce	4%
6	Research and services to research	2%

The article comments, probably accurately, that small businesses are highly innovative and hold out a promise for the future.

A total of 126,785 firms, 58.9% of all state owned firms, have been privatised to date, according to Braverman²⁷, the first deputy head of the State Property Ministry. In 1997 sale of 3,353 firms raised 18,653.5 Bn old roubles. He added that in 1997 over 75% of a GDP of 2,675 trillion old roubles (billion NR) was contributed by the private sector. This proportion is disputed by other officials; it is likely to represent trading, especially by the giant energy near-monopoly firms such as Gazprom and Lukoil, rather than manufacture or agriculture. What the figure does suggest is the appalling losses made by the State owned manufacturing firms and infrastructure.

The system employed in Russia was the worst possible. The population was given, gratis, vouchers with which they could buy shares in a company that was to be sold off, or to put toward a flat. The theory was that all state property belonged to the people and should be given back to them individually; a nice idea but it did not work out that way. Vouchers could be traded. What happened was that the then directors of lucrative state enterprises and other top people managed to buy a controlling packet of shares. They knew what would make money quickly and who to associate with. These people bought the only segments of the economy that could produce vast income, namely gas, oil, mineral, timber extraction and distribution, scrap metal and semi-finished steel products for export. The heads of the old firms are now at the top of the Federal, Republican, Regional and City Governments. In this way governments of Russia and Republics such as Kazakhstan are run by the seriously rich merchants who have captured power. The method was emulated all the way down to individual factories, whose directors are rarely in government but can exercise undue influence over government policy at Republican and regional levels. Furthermore they have taken every opportunity to cream off the assets of even poorly performing factories. The press and Duma are full of such charges and examples of blatant public corruption.

One form of public corruption is when officials demand payment for a service which in law they are duty bound to provide without favour of any kind. But Tsarist, Soviet and

Post Soviet officials have all demanded payment for such service; it is in the tradition. If you need a passport or visa in a reasonable period you pay, if you don't you may get it after some months, if at all. According to Rossiyskaya Gazeta, a newspaper that is generally in support of the Government²⁸ bribery and corruption as well as embezzlement of state assets is growing. It estimates that in 1996 over 5,000Bn old roubles (roughly \$1 Bn) were diverted from the State treasury into private hands through the direct involvement of officials. It gives many examples and states that many high ranking officials have been dismissed; some immediately find jobs in a corporation. In Tula, it reports, the Deputy head of the Oblast Administration, Shapovalov, is serving a 6 year sentence for illegal deals and the former Governor Sevruhin is accused of taking bribes to allow significant sums in the budget to pass to commercial banks. It asserts that some state officials, by virtue of their position are able to lobby on behalf of commercial and criminal structures, have incomes of \$300,000 a year.

The Budgetary Process

The Federal Budget ought to be a candidate for the Booker Prize for fiction. Year after year it seems to be constructed, not on realities, but on a mixture of hopes and fantasies which must strike even the authors as unlikely to be fulfilled. Its purpose is to present a picture that will satisfy the various interest groups that the government is looking after them and at the same time pretend to the IMF, EBRD etc that the government is embarked on a path of financial prudence and probity which is leading to international recognition of their financial respectability. If, however, one looks back at past budgets one sees little sign that, for example, there are fewer men under arms, that the defence factories are being commercialised successfully, that other demands on the budget such as the need for subsidies for the basic economy are being reduced, through closures of loss making state firms, improvement in efficiency in the remainder and so on. Budgeted incomes are not achieved nor are the expected and promised expenditures. No one is or should be fooled. When the budget is submitted to the Duma for approval, this is invariably denied at first and second reading. The budget for a current year is rarely approved before end of February of the same year. But the Duma will not throw it out nor defy the Government on major issues. The Government in such cases is entitled under the Constitution, to dissolve Parliament. The delegates would not like this since they will lose their not inconsiderable personal privileges including salaries, office and apartment in Moscow, secretarial aid and cars; all this in addition to similar perks in their home locations. Their defiance is one of sabre rattling as well as some useful and informed criticism by such opposition leaders as Yavlinskiy, who has occasionally made some sensible economic statements over the past few years. The party of Power usually has few persuasive arguments in defence of the budget, but it goes through eventually. The most persuasive argument is Dissolution. The process changes little from year to year, nor does the content. Let us examine in broad outline some of the key areas of the economy covered by the budget.

Defence

Defence still figures as the largest individual element in the Federal Budget, to which must be added elements of the expenditures of lower level authorities. Although it is officially recognised that Russia has no external enemies who threaten war, it is not only official policy to restore the armed forces to their former capabilities of dealing with potential threats but it is also in accord with the psychological and emotional concept of Russia as a Great Power which demands a large visible effective armed

force. The government talks and behaves as if it shares this view. The official federal defence budget amounts to about 3.5-3.8% of published GDP.²⁹ This is about 20% of budgeted expenditure by the Federal Government. Shlykov provides an interesting Table of official Soviet/Russian defence budgets.³⁰

Years	Billions of Dollars	Ruble-dollar Exchange Rate
1989	15	0.70
1993	7.4	932
1994	18.0	2204
1995	12.8	4554
1996	15.1	5200

It is also true that budgeted sums do not necessarily get paid. Only half of that due reached the MOD in first three-quarters of 1996 and 1st quarter of 1997. However true defence budgeted expenditure probably lies between 8-12% of GDP if one takes into account:

* items excluded from the budget but which lie within NATO classification of defence expenditure.

* Expenditure by republican, regional and city authorities which may or may not be covered by the Federal Government.

* Expenditure on Armed Forces not reporting to the MOD but to about another two dozen ministries.

These amount to approximately 500,000 men under arms. The MOD still has 1.75 million men under arms. Whether these are establishment figures or actuals on the strength is hard to say. But even if the units are under strength the total is far in excess of the 500,000 total armed forces personnel that NATO calculates that they can afford. In their candid moments some in the Russian Government and MOD itself concede this estimate. But the Opposition violently accuse the Government of destruction of the armed forces and treason in even contemplating a run down from 1.75 million to the projected 1.2 million. The current talk³¹ is to release from the Armed Forces over the next five years a total of around 250,000 officers. But this figure is hedged by the statement that they, like so many of their current comrades, will be retained unless they can be provided with living accommodation, since the law forbids release without an apartment.³² The government owes the military around \$2 billion in back pay alone³³ but, as always, claim that this debt will be paid within a few months. The Government has admitted that it uses IMF and other loans to pay arrears of wages to the military, which are reported to be \$1,600 per person³⁴ and to other employees such as coal miners, employees in rail transport and electrical energy generation and distribution. In addition there are items paid by 'non-budgetary sources' and expenditure, often hidden, on military projects as 'science, research and development'.

Industry and the environment

With 70 years of an agenda of excessive militarisation of the country, which denied adequate resources to every other activity, an autocratic, centralised leadership that demanded volume and speed of performance in every project, it will not be surprising to learn that industry, apart from the Military-Industrial Complex, agriculture and all the transport and communications infrastructure is well below the standard of design, manufacture, maintenance and operation that is expected in advanced industrial countries. And so it is. It must not be thought that Russian managements do not have objectives; they did and still do. But Soviet objectives were primarily to fulfil the quantitative elements of the Plan; now, to fulfil orders from anyone, and secondly to produce within the demanded time scale. Nothing else figured. All these sectors have been starved of investment for decades; much of what has been provided has been misapplied and in the case of some modern imported kit, misused. Factories are usually badly laid out; the storage and handling of materials and work in progress is lamentable and wasteful; energy utilisation many times that experienced in the west; unsafe practices abound. The number of fatal accidents per 1,000 workers is about 12 times the British average over the years 1991-96. One miner was killed for every million tonnes mined in Russia.³⁵ The lost time accident rates, which in Britain are monitored and the subject of much management activity to reduce them is not recorded in Soviet or Russian figures given to the International Labour Office. The upshot is low productivity, high reject rates of product, variable properties of engineering materials and lack of a proper range of many of them. Agricultural output shows that output per person employed and per hectare sown is about 5 times less than in climatically comparable States of USA, and about ten times less than that of Denmark and Britain.

The reluctance of the hierarchy to abandon or drastically reform the manufacturing sector is seen at its worst in the Military-Industrial Complex. But it is also felt in every state owned sector, which still consumes enormous subsidies, employs millions and produces little that is saleable.³⁶ Mercifully, as seen below, a few foreign firms, as well as some bright, sensible young Russians who worked in the State defence factories, are founding small scale industry from whose example eventually major manufacturing practices may improve.

The effect on the environment of this frenzied but poor activity is catastrophic.³⁷ To give a few examples: most cities, even St Petersburg and Moscow, have insufficient effluent treatment stations; raw sewage pollutes the water table, the local rivers, seas and lakes. This is in spite of the decrees giving production of clean water a high priority between 1976-88. There are strict laws but they remain mostly on paper. According to a Russian environmental expert, Yablokov, oil seepage into the ground and water amounts to between 7-20% of all oil produced, the variation is between regions studied.³⁸ In my own experience, in purchasing foreign 'turnkey' factories, in many cases Russians omitted the environmental and also safety features to save money. Non-fulfilment of the Plan had more serious financial and other consequences than ignoring environmental norms.

UNESCO reports that the Baltic Sea is the world's most polluted, in the Black Sea bacteria levels are 200 times higher than world norms and is regarded as dead by UNESCO.

But, on the credit side, the emerging Green Movement did have some effect in late

Soviet times, stopping some of the stupidest, least effective and most harmful projects. They may do so again. The situation has worsened since the collapse of the USSR. As a result, people are increasingly suffering from respiratory diseases and those of the internal organs, heart and cardio vascular system. To put right the failings of the past will involve billions of dollars that will, inevitably, be diverted to projects considered more important but also a radical training programme for all managerial, scientific and technical personnel to enable them to perform to international norms. Unless this is done new projects will be no better than those from the past; present operations will continue to present hazards. There is no indication that such policies and actions figure in the budgets of the Federal or of other governments in the Russian Federation. Things therefore can only worsen.

Communications

More and more contracts are being awarded to foreign firms to re-equip telecommunications systems.

The railway system is also creaking; it needs much investment. But Nemtsov announced on 13 February 1998³⁹ that the Ministry of Railways had in 1997 repaid all back wages, raised productivity by 10% and made a profit of 10Bn NR; it had cut freight rates by 10% and passenger travel prices for distances over 4,500 km by over 30%. This seems to have been accomplished by smoke and mirrors since the price cuts he announced were the exact opposite of those effected in December 1996 when the same ministry imposed a rise of 0.8% on freight prices following a fall in the volume of freight by 22.8% on 1995 and passenger kms by 8.3% because of rising prices and falling demand. Russian railways have a long tradition of competent management, but also more recently a history of interference from the politicians, serious interest by criminal gangs and corruption involving border guards and customs authorities. The Trans-Siberian railway now only carries 20,000 containers a year; in its Soviet heyday it carried 140-180,000 and earned a reported profit of \$2 bn yearly (at the artificial rate of exchange of 0.70 Roubles = \$1). Primorskiy Krai Governor Nazdratenko seeks to revitalise it, since it could halve journey times from Taiwan to Hamburg, but it costs at present rates \$1,000 against \$800 for sea transport. The Government supported by some dreamers in St Petersburg, however, have been promoting a 'prestige' scheme for a high speed train to Moscow. It seems to have run into the bog due to lack of financial interest and objections by environmentalists.

The air transport field is already heavily reliant on the use of foreign airplanes; Soviet planes are neither economical to run or indeed safe enough to command respect. Some of them have aerodynamic deficiencies, all their engines have a short life and are fuel guzzlers, the latest avionics are ambitiously complex, and are responsible for the disorientation of the military pilot which caused an accident at Le Bourget in the summer of 1997. They are also fitted to the Ant-70 very large military transport plane that Russia and Ukraine are trying to sell to the west. The table⁴⁰ below gives the accidents year by year:

Years	Incidents	Deaths
1984	166	384
1985	142	414
1986	187	324
1987	176	47
1988	159	120
1989	175	107
1990	195	203
1991	173	249
1992	166	253
1993	122	349
1994	71	321
1995	74	246
1996	57	292

‘Over 80% of crashes were blamed on air crews, 18% due to technical faults, including poor fuel. Water in the fuel was blamed for one of the crashes which killed many people in 1997, overloading and incorrect balancing of the load, unregistered passengers and cargoes (sic) and insufficient fuel carried. The wish to maximise profit was blamed as well as general political, economic and social difficulties’.

Soviet airfields and airport terminals are also primitive and require modernising in communications, radar, air traffic control systems, and adequate, modern means for handling cargo and passengers. This is already happening, with western money and using foreign equipment and contractors. The management of the transport system is undergoing much reorganisation but also has much to learn from abroad.

Road transport is also inadequate; the main roads are not too bad; foreign firms are investing in badly needed service stations along the main routes, especially those leading to the west and the Baltic States. A new ring road is planned for St Petersburg; the present cluttered roads carry a considerable volume of freight across the Finnish border. Much remains to be done to get border clearances to work with acceptable delays and practices. A recent report⁴¹ details problems. The courier firm DHL is quoted as saying ‘customs officers, who often see themselves as police rather than facilitators of the economy, should be educated about what business needs.’ It added that a lack of resources and low pay lead to an untrained, unmotivated corps of customs officers.

Unemployment

Official figures claim a modest proportion of unemployed people, around 7% of the

work force. However the real figures are several times higher but are cloaked by several facts.

* As was pointed out above, many workers are reluctant to sign off their current place where they are registered for work in their 'working passbook' even though they may be offered little or no work and may be either on unpaid leave or receiving their salaries several months late. This is because they have benefits in kind. They are effectively idle.

* Others may be 'moonlighting' or working in the grey economy, which amounts to a significant share of the national economy; some senior members of government and commentators from Institutes that 'study the economy', say around 50%.

* In any event the productivity of workers everywhere, in factories, fields or offices is low; every branch of civil and military activity is overstaffed.

The State job centres run by the Labour Ministry are beginning to get into gear, to find jobs for people, but they are underfunded and unemployment pay is not enough to provide even a subsistence existence.

More encouraging is the growth of a new middle class, who are mostly young. Those with good English and computer, financial or legal skills earn well, around \$1,000-2,000/month in service industries whether foreign or Russian owned firms. Medical doctors, surgeons and dentists can legally work part-time for a pittance in the State system but can earn larger sums in the private sector on a part-time basis. Older people, for example those with sound administrative experience and who can rapidly learn how privately owned firms work, also do well, but mostly in service industries. There are some who have become entrepreneurs or directors of small-scale manufacturing firms, which are regrettably not too numerous. Such people succeed in the small but growing number of firms set up or jointly managed and owned by foreign firms of high calibre. The joint ventures lie mostly in extraction and distribution of oil, gas, minerals and timber. Foreign firms have been successful in food processing, packaging, tobacco, construction and building and increasingly in pharmaceuticals and medical services. The future of Russian industry must rely on Russian engineers, scientists, managers and the work force learning from the best practices of foreign firms.⁴² This can only be done in the firm, by example, and that relies on the foreign partner retaining control. The fashionable methods of classroom learning in Business Schools or worse, distance learning⁴³, are not a substitute for learning on the job; these methods may, if they are soundly based and work closely with actual practice, provide a useful understanding of how things are supposed to work. Some reports⁴⁴ emphasise the number of private firms in Russia, their rapid growth and the claim that 40% of all employees work for them. In my view these statements are misleading. How many of them are in manufacturing and how many trade usefully to the economy? One suspects that many are shell companies engaged in 'services'.

Social services

The old Soviet order has collapsed. Pensions are derisory and usually paid late. The Government accuses regions of paying pensions and wages by withholding taxes due and threatens to deny them federal contributions if this continues. By law all employers are obliged to pay a proportion of the wage bill to a pension fund; the state is still the largest employer but ignores its own law. It uses IMF and other loans to pay current account debts of this sort.

The free State medical service is now badly run down and understaffed. Many doctors and paramedics moonlight quite openly in private clinics. The condition of even the best hospitals was poor in the last Soviet years, now they must really be struggling. The Soviet pharmaceutical industry was never adequate, either in the range or quantity of products available; it is worse now. Foreign medicines are imported in large quantities and at high prices. As a result health care is increasingly unavailable to pensioners and those at the bottom of the income pile.

Every report points to worsening health, increased use, especially amongst the young of drugs and alcoholism, the traditional scourge of Russia, is increasing in every class and age group. Due to these factors, to poor public health, to polluted water and air, to poverty, to a sense of helplessness and an embrace for every kind of degeneracy spawned by TV advertising, to the poor conditions of prisons, a general decline in health is reported. The expectancy of life has over the past ten years dropped by ten years. The Military Commissions report that over a third of those presenting themselves for military service at 18 are rejected due to poor health and that a third have already a criminal record. Venereal diseases were almost absent in the last decades of Soviet times; so much so that it was difficult for medical students to become acquainted with their symptoms. They are now again rife; dysentery and TB are now again endemic, as is cholera in many regions and cities. Social morality is also weakening; there are more abandoned children.

Social conditions are reverting to those of the 19th century when even in Russia they were alleviated by private charities supported by the richer and middle classes. The seriously rich founded a range of social support services and also funded museums, galleries etc. It would be good if the present seriously rich were to begin to emulate their predecessors. The history of tax-exempt Foundations in USA⁴⁵, however, shows how easy it has been for those so inclined to benefit themselves politically or economically in a competitive environment. It took a dogged Texan congressman Patman to put in place an effective Tax Reform Act in 1965 to prevent this blatant abuse of wealth. It will of course be no problem for the rich Russians to create for themselves an even greater advantage once a decent tax code is created and applied.

There is as yet little sign that the New Russians will become good citizens, pay their due taxes or become philanthropists like their predecessors before 1914.⁴⁶ However voluntary organisations to help the disadvantaged are springing up, especially in regions where the governor or mayor understands their supportive role and allocates funds from official sources to them. Some of these organisations report⁴⁷ not only successes but financial aid from local businesses and individual businessmen who give on impulse and are not yet in the mode of planning regular support as are their western counterparts. The masses are also unaccustomed and too poor to contribute to 'flag days' for charities, although lots of people were putting money into collecting buckets for the rebuilding of the Shrine of Christ the Saviour in Moscow in 1997. Furthermore, few would trust home-made charities aimed at relief of distress to be run honestly. This is a pity since it is noticeable that it is the poorer people who give to beggars in the underpasses to the Metro. There is a thousand year old Russian tradition of charity, mutual support and generosity amongst the people, especially the peasantry with whom the urban classes are still quite closely connected.

The Orthodox Church, which also receives funds from co-believers in the Diaspora, is supporting children's hospitals and residential homes. But the Church is unlikely to become a major beneficiary of charity by the rich and thereby to become a vehicle for significant good works. This is because the Russian Church was and regrettably still

is, rather materialistic in its own aims whilst preaching to its faithful the virtues of continuing to suffer earthly tribulations in the hope of rewards in the afterlife. Militant anti-exploitational theology and criticism of the Party of Power seem to be absent.

It might just be possible to persuade the New Russians to found charitable foundations and to alleviate the effects of poverty in order to defend their wealth and position. Although the Russian people are well known for their ability to suffer much hardship in silence, they have shown in their history that even their patience snaps. The Communist and Nationalist Opposition is waiting, ready, and indeed relies on the votes of the people who see themselves as downtrodden and the losers from the regime of the Party of Power.

It is plainly not adequate for western sources, including emigre Russian churches, to shoulder the burden of charity; they can only provide a small fraction of the funds urgently needed within the former Soviet Union.

Section two

‘Why can’t a woman be more like a man?’⁴⁸ or why Russia cannot be like us. British-v-Russian socio-economic conditions throughout the 20th century.

The British example as a convenient datum

The post First World War aims of the middle classes and landed gentry of England were to return to ‘normality’, namely a country in which the social and economic contrasts and divides of Edwardian Britain were maintained. The working classes, of course, looked forward to a New Britain fit for heroes to live in. Some in the middle-class, including demobilised officers, shared this vision. To some degree Lloyd George and the Liberal party articulated these aims; they had introduced the first elements of social welfare for the poorest and most disadvantaged sections of society. In spite of these political elements and those of the middle class Fabian Society, the rise, first of the Independent Labour Party with such spokesmen as Kier Hardy, followed by the Labour Party itself, showed that the working classes saw the need for a political party of their own, based on the Trade Unions, to fight for social justice outside the middle class parties whose interests were not perceived to be theirs.

The prevailing economic policies of the ‘bourgeois’ parties, to use the convenient Marxist portmanteau label, saw economic prosperity to continue to be based on low wages, alleviated by charity run by the middle classes. Charity was not perceived by the Labour Movement, with its Trades Unions or by such people as George Bernard Shaw, as an adequate substitute for policies which would lead to a prosperous working class or to adequate support for the under-class who could not work or find work. The war, however, changed the pattern of employment, especially in domestic service. Many women had worked in offices and factories and replaced men. These women had tasted a different world from that of domestic service. Henceforth living-in servants would be less common except in the ‘great houses’ of the seriously rich.

The inter-war years saw continuing struggles by British industrialists and agriculturists to maintain their share of world trade against other rapidly industrialising countries. The terms of trade were swinging inexorably against them. Germany was bent on revenge for the Versailles Treaty and reparations; it was developing anew a war machine based on advanced technology and took steps to cripple, by subsidised production of goods that were at least the equal of the technically and managerially advancing British engineering and optical industries. The owners of traditional industries, such as stevedoring, coal, steel and shipbuilding and mechanical engineering saw no way other than to reduce wages in order to remain solvent; some industries were reconstructed, ie closed or merged, but many, perhaps the majority, took no steps to improve productivity through modernisation. That lesson was learned only after the end of the Second World War and then by studies of German industry and of American practices. The result was confrontation between the classes, culminating in the 1926 General Strike which ended in defeat for the workers. The 1920s and 30s saw much class strife, with troops being called out on many occasions.⁴⁹ The failure of the Western financial system in 1929-34, exacerbated especially by American macro-economic errors, accelerated these international economic battles, which resulted in the closure and failures of many British and western enterprises.

The acceptance of Adolf Hitler as German Chancellor with his rearmament programme and military aggression was the background of the class struggle and the continued impoverishment of the lower classes in USA, France and Britain. Only rearmament in the USA⁵⁰ and UK stimulated the economy and began to get the people, the land and the factories back to work. Nevertheless, Britain and America contained the class divides and struggles without significant bloodshed or an approach to the brink of civil war. This was not true in Germany, Italy, Spain, and to a lesser degree in France. But it is the Anglo-American experience which I wish, in the main, to compare and contrast with that of Tsarist Russia and its successors.⁵¹ Public and private charity played a significant role in pacification of the working class whose militant wing failed to lead them to a revolt or to a repeat of the General Strike.

The class struggle in Britain was put into practically complete abeyance⁵² almost from the outset of the Second World War; there is some evidence that the TUC had a tacit agreement with the Government to support the rearmament of 1938-39 for a promise that after the war things would change in their favour. After the fall of the Chamberlain Government in the summer of 1940 the Labour and Liberal Parties joined the Government and entered the cabinet. Quite early in the war the Government recognised that after the war there could be no return to pre-war 'normality'; it planned for a comprehensive social support under William Beveridge (pub 1942) and an educational programme by R A Butler (pub 1944) aimed at the masses. This approach to social policies, largely bi-partisan, was pursued by the incoming Labour Government from 1945-51, some would say rather too vigorously, and by the succeeding Conservative Governments.

It is almost certainly true that the wealthier classes began to recognise shortly after the end of the war, the advantages to them of the increased purchasing power of a working class which was beginning to earn rather more than a subsistence income. The 'Daily Herald', a newspaper supporting the Labour Party used to carry material showing the advantage to commerce and industry to advertise in the paper because the purchasing power of its largely working class readers was a significant economic factor and was larger in total than that of the readership of the 'middle class' papers. The differences in income, especially in earned income, were beginning to narrow. Whether the disposable income of the working classes was so significant at the time is another matter, but throughout the 1960s and later this must certainly have been true. I believe that it is now fully appreciated by the executives of business that their firms depend upon the disposable income of the lower social classes at least as much as that of the professional classes. Were the disposable income of the lower social classes to contract seriously then the prosperity and very existence of many service providers and firms, as well as of manufacturing, will be threatened.

One may conclude from this argument that there is, and has been since perhaps 1939, a largely unspoken Social Contract between the lower and higher income earning groups not to upset this balance, not to 'rock the boat', and indeed that 'they are all in the same boat', upon whose prosperity they all depend. The British Labour Movement has, certainly in the last decade or so, almost completely accepted that there are no longer 'two sides of industry' with their aims in conflict; they are seen as interdependent, except by a few die hard extremists. It has taken nearly 100 years for the British Labour Party to see the failure of traditional socialism to achieve their social aims.⁵³

The American Labour Movement, by contrast, apart from a few extremists in the 1920s

and 1930s, never adopted the aim of nationalising the ‘means of production, exchange and finance’; they always saw that their interests in an increasingly equitable society lay in making capitalism work in partnership with capital and management. (As in all partnerships there was, of course, strife between them.) Toward the turn of the 3rd Millennium the ‘working classes’ in USA, Britain largely see themselves as ‘middle class’.

Charity has lost its stigma amongst theoretical socialists who in previous generations argued that it excused the ruling class from the necessity for State financing of all welfare. In the re-labelled ‘Voluntary Movement’, the voluntary bodies and the volunteers themselves form a parallel source of thought, supply and financing of social services. These extend to retirees from the Armed Forces and their families⁵⁴ and to the disabled, handicapped and disadvantaged in society generally. They form an accepted part of the national armamentarium of social support; it is generally recognised that the State cannot finance everything nor can it react swiftly enough to deal with minority issues.

The Voluntary sector, now a business in its own right and often professionally managed, attracts donations from the general public, who also provide thousands of volunteers for them, commercial firms and individual millionaire philanthropists. It is socially advantageous for even the ‘nouveaux riches’ in Britain and America to donate large sums for such causes. Their charitable contributions rather than the means of earning their wealth are often the reasons for award of ‘honours’. This is one of the ways in which ‘new money’ can become as socially respectable as ‘old money’ both in England and America. Charitable donations by such individuals and by commercial firms provide a significant share of funding in Britain for medical and other scientific research. Indeed there are some people who argue persuasively⁵⁵ that private funding for research produces better results more effectively than does the formal State apparatus working through the research councils. The Voluntary societies and philanthropy form an essential component of the social contract between the rich, the poor, the governed and the government. The ‘deserving recipients’ of charitable work take the role of charities as a normal aspect of social support. The only residual antagonism might, some say, lie against any demonstration of patronising attitudes, moral superiority, or overt ‘noblesse oblige’ from the donors or aid workers.

This social contract underpins the stability of Great Britain, provides validity and legitimacy to society and to Government in a continuing attempt to advance toward a more prosperous, equitable and sustainable society where all can recognise ‘fairness’, another good English word. It is possible that the culture of very large personal gain may undermine this social contract, but it is also possible that the broad masses will accept it partly because of the chances for them to win large sums through the lottery and partly because there is little manifestation of starvation amongst even the poorest.

At any rate no class-based social revolution has a remote prospect of even starting. The state of Britain is one of modest, incremental evolution of a market-based society which is unlikely to be reversed into centralised socialism or to social and economic chaos. The perceived threats to the British nation, relevant in this context, are the simultaneous ones of European federalism on the one hand and regional separatism between Celt and Anglo-Saxon on the other. It may be optimistic to assert, but one may with some confidence suggest that the British with their traditional commonsense and practicality will avoid the extremes of both trends.

How does Russia compare with this picture?

None of the key elements leading to social and economic stability and progress just described exist in Russia today, nor is there any sign that they will appear in the foreseeable future.

In my view, in post-USSR Russia there is neither a social contract of this type, nor the legal, religious, administrative, fiscal, financial structures or traditions to provide a social contract of the sort which will allow it to escape from its past or from the post-Soviet order with its chaos, corruption and decline of the basic economy and of the health and welfare of the masses of the population. Commonsense, practicality, mutual tolerance, the concept of service for decent but not excessive rewards, the idea of economic probity, the acceptance of evolutionary change, sensible, coherent government policies agreed and implemented by the various ministries rather than violent and contradictory decrees are not noticeable attributes in the history either of Slavs or of peoples who have lived for generations under one kind or another of authoritarian, arbitrary and patrimonial rule.

It follows that Russia is most likely to continue in its present conditions within perhaps a narrow band of improvement here and there and also down a generally weakening path for the mass of the population. This will not improve the stability of the State or of its relations with elements of its own society or with its neighbours.

The following section of the paper sets out the main reasons for this assertion. Let us take a brief look at the 20th century conditions of Russia: from Tsarist, through Revolutionary, Stalinist, Ossified Soviet to present day Spiv Reformed Russia. This picture is to be contrasted with the analysis of Britain through the past 100 years. It explains why Russia will not become like us. We can then understand more clearly the reasons for the present unsatisfactory state of Russia and its economy.

Critical socio-economic features of the terminal phase of Tsarism

Pre-revolutionary class divisions in Russia were much wider in every respect than in contemporary western Europe, England or America. By 1905, the year of the first serious revolt against Tsarism, the Russian peasant had barely escaped from serfdom; he was still liable to pay the land owners for his freedom. The rapidly expanding urban population in European Russia, mostly enlarged by the flight from the land, became the poorly skilled, badly paid factory hands who lived either in dormitories or in hovels with many people sharing a room in poor sanitary conditions. Their standard of living was far worse than that of their British contemporaries; Dickensian descriptions are closer to reality⁵⁶.

The clerical grades were more often than not filled by the progeny of the gentry class, sometimes on their way up the table of ranks but sometimes stuck there. Nepotism was the norm for such appointments. They were paid well above the level of the proletariat, but also drew upon subsidies from their family estates. This was the basis for the burgeoning 'civil service', sometimes treated as a sinecure at state expense for the gentry and nobility who also had their private incomes as an important element. Officers in the Army and Navy also came from the upper classes and depended also upon a private income to maintain what was largely a life of parades and leisure in the two capitals; life in the garrison towns whilst more boring was also lacking in economic hardship for these people⁵⁷. The professional classes, including provincial lawyers, doctors, engineers and entrepreneurs, formed a much wealthier middle class than their English contemporaries. They, like the British upper classes, but not their British social equivalents, could afford to travel widely and spend considerable periods

not only in the fashionable resorts of the Crimea, Finland and the Baltic provinces but also in the Spa towns of western Europe. Jews travelled to the Holy Land and painters studied in Italy and France. Some entrepreneurs, mostly traders but some owners of manufacturing firms, became seriously rich. Some of these people founded charities, created the important collections of Western and Russian painting which after confiscation by the Bolsheviks have become world famous in the galleries such as the Tretyakov in Moscow. The aristocracy, with their huge landed estates, lived in a manner which was not to be compared with that of the English landed gentry or aristocracy. Admittedly many of them squandered their resources on idle living, few cultivated their estates properly.

The gap between the incomes and standard of living of these classes must have been very much greater than that in England, although I have no figures to support this assertion. Tsarist society was furthermore dominated by a huge bureaucracy, which was widely corrupt in the sense that the law should have been applied and the service, that should have been provided to all without favour, depended on bribes and favours. Law had been arbitrary; the Tsars, like the Khans before them could grant or withhold clemency as they wished. The rulers, led by the Tsar and Tsaritsa, took for granted that, simply because they were rulers, they had the right to dispose of the property of the nation as they saw fit. Their example was, as a matter of course, followed by the Ministers, Governors and other rulers, military and civil alike. Bribery and corruption were the norm.

This 'normality' was of course a focus for attack by all liberals and socialists and seemed to fulfil the prediction of Karl Marx that capitalism was doomed to create the conditions for its own destruction. It was undoubtedly a major factor in the welcome by the opponents of both Tsarism and Bolshevism for the February and October 1917 revolutions. Many scientists, genuine 'intellectuals', engineers, army generals and officers not only sympathised but joined with the Bolshevik Government in the early years against the Whites, the Intervention and the Germans. The Bolsheviks were determined never to allow Russia to return to this normality. They destroyed 'Old Money', some of whose owners not only gave away fortunes to found schools, universities, art galleries, etc but also founded charities for relief of distress.

The destruction of this class was accompanied by the destruction of its more positive values along with those of the genuine intelligentsia. The current 'New Russians' have few of the aspirations to the norms of social respectability which in part drove the New Rich in the West. Although Soviet society was by no means classless, the normality of vastly separated wealth, income and standards of living did not return to Russia until the collapse of the USSR. As we shall see, it did so in full measure and in so doing, ironically, fulfilled another prediction of Marx that capitalism inevitably led to a widening gap between the working and ruling classes. The irony is that this has happened, not in the countries of advanced capitalism as he predicted, but in backward and Post Socialist Russia with its version of primitive capitalism in its second incarnation.⁵⁸ This phase combines the worst features of the first phase of Russian capitalism and the negative features of 74 years of Soviet Power, whilst the features of soviet society that gave the masses something above subsistence levels in more or less equal measure have sunk without trace. The Soviet period did create a hierarchy of social prestige and respect of its own, much of it socially very positive. That too has disappeared with the collapse of the regime and of the basis for that hierarchy.⁵⁹ No wonder that the condition of the present regime exercises the ire of the latter day Communists as well as explaining the nostalgia for the soviet past by many of the impoverished elderly and educated people and by those whose privileges in

soviet times have been largely wiped out.

The economic legacy of the USSR

There are some essential elements of soviet economic intentions and practice which have carried over into the practices of the Gorbachev and later the Yel'tsin 'reforming' regimes and also provide a simple explanation for current practices. All the post-Soviet Russian leaders completed their education in the soviet system; those of middle age were also working in the Soviet hierarchy.⁶⁰ It would have been unnatural had they managed to govern without reference to the structures and methods of their soviet past. The soviets, in their turn had also adopted many of the basic methods, prejudices, emotions and aims and also of course the bureaucracy of the tsarist past. The basic elements of the Soviet regime after consolidation of their hold over the country are well known and need not be repeated here. We should however be aware of the way the soviet economic system managed to survive central planning and the prejudices against orthodox western economic and financial methods as practised in a liberal democracy.

There were three financial systems working concurrently alongside each other:

1. **External Trade.** The State bought and sold everything. Imports were mostly technical goods, in bad times food, especially grain by the million tonne from N. America, occasionally after the death of Stalin some consumer goods. This was paid for in cash and credits, generated and backed by gold and by export almost entirely of raw materials and also of grain, even in hard times for the soviet people. The external account was entirely separate from that of internal trade. Soviet commercial negotiators acquired a reputation for tough but fair dealing, their credit rating was high and they never to my knowledge defaulted on a deal or contract. It goes without saying that there was rigorous exchange control; it was a serious crime to possess foreign currency, to import or export soviet currency; the latter ordinance is still on the statutes as every visitor to Russia sees on his Customs declaration. Much foreign trade was also accomplished through barter. This was especially true for trade between Russia and the 'socialist camp' to whom Russia gave arms and some industrial equipment in return for goods, for example sugar from Cuba and cotton from Egypt. The values of such trade again were set arbitrarily to suit the deal, the politics and propaganda value rather than upon calculated or true costs to Russia.

2. **Internal Trade.** The State owned and controlled the means of production and distribution; it set the transfer prices between enterprises as well as the final prices for goods sold to the population. These prices bore little relation to real costs and were fixed for political reasons. Costs were based on arbitrary, centrally set or approved values. The difference between costs and income in the enterprises were appropriated by the State and provided the means for supporting the long term political aims of the Party. These were primarily prestige projects with a military connotation, especially Space and rocketry, and those which might be used to persuade the Soviet people and the foreign fellow travellers that Soviet Russia was in cultural terms the equal, if not the superior, of foreign, bourgeois cultures. This trade was largely a non-monetary economy. Transfers of goods between enterprises were accompanied by transfers in the ledgers in the ministries. No money changed hands officially. Due to the inefficiencies of the soviet system, outputs rarely met the Plan, in spite of the large investments in useful projects. Many projects were left unfinished even in soviet times. Shortages were commonplace, enterprises with a plan to fulfil by the end of the month went to extraordinary lengths to obtain essential components from suppliers. It

was routine for them to employ 'fixers' who wined and dined the directors of their suppliers to persuade them to divert output to them in preference to delivery to others. The system could not work as it was supposed to on paper; consequently the most important part of the job of a director was to be seen to fulfil the plan so that his Minister could boast a success even if it was mythical. Only in this way would the director, his staff and workers get their bonuses. A shortfall from the Plan was a serious business, regarded as a crime; people would be accused of deliberate sabotage in cases of failure of a prestigious piece of equipment, project or a shortfall in the quota of output; a worker or engineer might be shot or serve 25 years for a glaring case. Engineers even in military factories were not doing a proper managerial or professional job; they were progress chasers and fighting the crisis of the moment in order to survive. Evolutionary improvement of performance was not a priority.

3. Consumption by the population. The State decided what proportion of its income from profits and foreign trade could be allocated to housing, utilities, education, medical services, pensions and wages. Intentionally, most of this social support was also non-monetary, heavily subsidised by the state; the population paid only a small fraction of the arbitrarily decided costs of these services. In the late 1980s a Moscow family with a joint income of 400-500 roubles a month might pay 15-25 roubles monthly for rent and utilities. Privileges such as heavily subsidised travel to and accommodation in a tourist resort were at the decision of local Party and collective organisations at the place of work.⁶¹ Even with the artificially set exchange rate of later soviet years of \$1=1 rouble, people's monetary income was small and yet they survived at a modest level which for many people did slowly improve.⁶² Consequently the need for money in circulation was quite small. People had no experience of having a current bank account, or handling money beyond their daily needs. Savings were quite high although interest was low.

With all these controls in place what were the economic reasons for the collapse of the USSR? The most likely answers are:

1. The insupportable burden of the military and related budgets, running at something like one third of GDP. To this can be coupled the expenditure on other prestige and grandiose projects begun for political reasons and often uncompleted.
2. The reduction of return on capital investment due partly to poor design of equipment for civilian purposes and workmanship of soviet engineering industries and partly to poor management of the production enterprises themselves in every sector of the economy. This last factor also resulted in poor use of imported production equipment, even the latest.
3. The damage to the health of the population due to massive environment damage and pollution.
4. The continual weakening of a basically primitive infrastructure throughout the Union.

In short the economic and social failure of centralised socialist planning and performance. Successive Soviet leaders from Khrushchev onward were correctly briefed by their experts on these matters; Gorbachev was however the first to take notice and to try to act on the warnings.⁶³

The round-about of Russian reforms post 1985

Gorbachev's blunder, in my view, was to try to carry through the essential long term and radical reforms needed in the country through a reformed Communist Party which would retain its leadership. He knew no other way. The stage was set for a new beginning; but there is always a legacy, which the new actors will bring with them and follow consciously or unconsciously. This mental and psychological baggage from the tsarist and Soviet past can be summed up as follows:

- * Possibly due to long seated sense of inferiority, a need constantly to promote and support the idea that Russia is a Great Power and to bolster this with a huge, very visible Armed Force backed by an equally large defence R & D and production industry;

- * Projects that can be used to demonstrate superiority in culture and space regardless of expense;

- * A feeling that the show is at least as important, if not more so, than the realities. This applies also to minions fooling seniors that the Plan and their orders have been carried out.

- * In this way the policy that inspired the Potemkin Villages in 18th century led to claiming in the 20th that all significant inventions were made by Russians and also the superiority of Soviet/Russian science and thought in every field of human intellectual endeavour⁶⁴. Genuine science under the soviet regime had its best days in the middle 1920s when it was carried out by proper scientists educated under the old regime and before they were shot, driven into exile or had their objectives perverted.

- * These feelings of Russia as a Great Power are gratified also by always having the 'biggest' of everything which by definition must be best.

- * Doing things fast, especially if an achievement can be made to coincide with an important anniversary.

- * Quantity and speed of execution come before all else including quality, waste of resources, effect on the environment, ecology, health and safety of the people.

- * The automatic assumption by the Rulers that they had the right bestowed by virtue of their office to take whatever they wanted from the State and Nation. This Tsarist concept lay dormant during the first half of soviet rule but under Khrushchev first the Golden Youth, the children of the Party apparatchiki, and then the apparatchiki, themselves began to indulge in serious privilege, corruption and amassing of private wealth and property. This tendency accelerated unashamedly during the last decade of Soviet rule.

- * The control of the economy, with frequently repeated warnings concerning the dangers from external enemies and the emphasis on heavy industry and armaments, coupled with indifference for the population led to an ever widening gap of the way of life, even in a basically cashless society, between the ruler and ruled.

- * The control of the nation was accompanied by a huge and growing bureaucracy, which through interfering with the work of the 'doers' - who were in any event not terribly competent - managed to worsen the economic performance of the country.

* The socialist, central planning system, coupled with the above defects, ensured the failure of the 5 year Plans, the grandiose projects, the failure to evolve an efficient use of resources and to the misuse of even the best imported production equipment.

* In spite of a professional caste which was highly educated in theoretical aspects of their subject, its members were untrained, un-motivated to perform on western or Japanese standards norms and objectives. This was partly due to the dogma shared by political philosophers that theory was the key to success in technology as well as in political affairs. This attitude was exacerbated by the initial Bolshevik leadership who were nothing more than scribblers and conspirators running underground pamphlets and small cells of co-believers. They had no experience of doing practical things properly. Their successors were chosen from the same mould. Party education in Marxism and experience of Party work counted for more than professional competence in many spheres.

* Indifference to the needs or wants of the civilian life of the nation prevented the design, manufacture and marketing of goods and services that would provide value for money or be in any way competitive with imports. Most factories are 'value subtractors' in the sense that their products often command less money on the open market than the materials they are made from. There is no tradition of feedback from the market. A sellers' market guaranteed that the unfortunate consumer had to 'take it' rather than 'leave it'. Consequently the physical as well as intellectual legacy to the economy was that of a backward, third world country.

* The tri-partite methods of accounting for trade with its essentially cashless internal trading system led to much barter and other cashless trade.

* The ignorance of Soviet economists of the ways of an efficient market economy operating under an equitable rule of law led to bizarre experiments of a quasi-market economy in order to overcome the glaring inefficiencies of the Soviet system: none of them produced the hoped-for results.

* Nevertheless the Soviet hierarchy knew that the private enterprise system of the capitalist world gave better results. Therefore the new rulers were open to western economic ideas, which however they did not understand. Unfortunately for Russia and for the world, they were given the wrong advice by western economists, which basically recommended a simplistic, 'top down' reform approach. This melded well with the instincts of Russian leaders and bureaucrats who were also accustomed to a top down system of command and control. They also succumbed easily to capitalist buzz words from the management consultants. These were merely accepted without any deep study or analysis; they just replaced those of the old, now discarded Party dogma.

* The absence of a tradition which restrained people from succumbing to temptations for personal self enrichment by any means regardless of law or conscience.

* The absence of a system of law that people, or indeed the ruling elite, respected or obeyed. Indeed there was a habit of writing Constitutions, Laws, Decrees and Decisions which had no practical effect and in many cases were not intended to have any effect except that of propaganda.

* There remains a yawning gap between talk and action, talk is cheap, action difficult. One must not judge Russia by the Constitutions and laws it enacts. It is the mode of their implementation or the lack of it that governs the way real life and business can be conducted.

* The 'nationalities' question, which was never satisfactorily resolved either in Tsarist or Soviet times, still remains a source of instability within Russia. By extension this issue, together with the long-standing inequalities of wealth, embraces the tensions between the regions and the twin capitals of St Petersburg and Moscow.

* The habit of demanding subsidies for everything, for every sectoral economic activity and also for the regions. The idea of earning enough to become self-supporting is rather foreign to former communist industrialists, factory and farm managers.

The above inventory of goods 'taken on the voyage from tsarism, through Soviet Communism to the Reforms of the Gorbachev and Yel'tsin administrations may not be complete but covers the most important of the flawed inheritance of the current regimes. This is exacerbated by the key errors of their western economic advisers, whose mistakes are due to ignorance of Russian realities. This also provides the basic reasons why Russia is not likely to escape its present muddle, chaos, in-fighting between ministries, conflicts of policies and decrees, its present stagnation of the sinews of the economy, its increased reliance on export of raw materials and purchase of foreign technology from electronics and modern cars and airplanes, even to quite basic run-of-the-mill technology and increasingly not only basic foods but luxuries such as foreign vodka, bottled mineral water and soft drinks. There is little attempt to improve the ability to design, make, service and market things like this independently. There is only talk of import substitution. With everyone's eyes on the top, on such things as a stock exchange and floating Government bonds abroad, no real attention is paid to things at the base of the economy.

In these circumstances, one cannot predict even a modest incremental advance to the kind of society in which honest businessmen will feel comfortable. They may, with difficulty learn to flourish. The mass of the population cannot look forward to maintaining their present, miserable existence let alone look with confidence to a significantly improving economic future for themselves or their families.

ENDNOTES

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1. East-West Commersant, Vol 5, No 8, pp4-5, April 30 1997.
 2. Ye Vasil'chuk, Finansovyye Izvestiya, 29 January 1998, p2.
 3. There are other, more sober estimates. 'Trud' published various estimates of capital flight since 1991 and made it \$60-70 BN. Deutsche Morgan Grenfell thought the 1996 figure alone was \$22.5 BN and the Russian Central Bank gave \$8 BN.
 4. Inside Russia & the fSU, European Press Agency (EuroPA), 16 February 1998.
 5. G Lisichkin in Rossiyskaya Gazeta, 24 December 1997, p3.

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6. Quoted by D Kirillov in *Finanstovyye Izvestiya*, 30 January 1997.
 7. Yu Yakovets, *Finansovyye Izvestiya*, 21 December 1995.
 8. *Segodnya*, 6 February 1997, p2.
 9. The city of Saratov held the first land auctions in the RF on March 5 1998. Plots sold many times above their starting price. BBC Summary of World Broadcasts (SWB), 5 March 1998.
 10. In 1993-96 I was working with a senior official in the Russian Ministry for Defence Industries; he had realised that it would be beneficial for the factories to reduce their manufacture of every component of their products, to encourage specialist firms to act as sub-contractors and to concentrate on assembly. He insisted that in Belgium there was an organisation which purported to act as a clearing house for firms requiring components and putting them in touch with potential suppliers. He believed that this was the way that business was done in the West and therefore it was right for Russia. He found it hard to accept that firms like the Ford Motor Company or GEC had a purchasing department to deal directly with potential and actual suppliers. The direct buyer-seller relationship is indeed hard for someone brought up in the Soviet system to grasp. There is after all no need, or role, for a central bureaucracy.
 11. I went to the party in the 'Teddy Boy amongst the Boyars' building in the Kremlin that celebrated the first anniversary of this menagerie. At a time when ordinary Russians were almost at starvation point, the vast hall was filled with expensively but crudely dressed and bejewelled young people whose language, subjects discussed and eating habits were shocking. This was definitely not the Russian intelligentsia, nor indeed the Soviet nomenklatura.
 12. Goskomstat, 1 May 1993.
 13. For example an article in *Central European Economic Review*, February 1997, p29, by Elizabeth Williamson on her journey on the Trans-Siberian railway explains a lot; the farm labourers earning \$40-80 a month, the 'shuttlers' of Russians and of all nationalities including Mongolian traders smuggling cheap goods from China into Russia, bribing the train staff and customs officers. A book worth reading, also by an Englishwoman, is about life in an urban provincial city on the Volga. 'The little Tenement on the Volga' by Caroline Walton, 1993/94.
 14. For a thorough discussion on economic matters especially on inflation and the industrial collapse see 'Assessing Russia's economic situation at the beginning of 1997', Jacques SAPIR, Directeur d'Etudes à l'école des hautes études en sciences sociales, Paris.
 15. SWB Weekly Economic Report No 526, 27 February 1998.
 16. SWB, 27 February 1998.
 17. 'The crisis in the Russian economy', V V Shlykov. Strategic Studies Institute US Army War College, 1997. [Http://carlisle-www.army.mil/usassi/](http://carlisle-www.army.mil/usassi/).
 18. IOUs are traded at a significant discount; the current rates for those issued by 'respectable firms' are quoted regularly in *Finansovyye Izvestiya*. They range from 20-

80%. As a result the price set by the seller to a buyer offering to pay in IOUs is raised to compensate.

19. I travelled in a soft coupe a couple of years ago with the retired general i/c this outfit. We had an illuminating night time discussion. I did not come away confident in his ability to collect due taxes or to avoid corruption amongst his officers.

20. SWB, 27 February 1998.

21. Rossiyskaya Gazeta, 18 December 1997, No242 p3 gives a table from January-October 1997. Total in to federal budget 157,386,466 Mn R. Out 23,607,969.9 MN R.

22. I was present when, few years ago, three Kazakhs burst into the office of the general director of the Minsk Tractor factory and yelled 'where are the tractors you promised us?' The director calmly replied 'you will get them when we begin to receive the shipments of grain you promised'. With that the conversation ended. Surely letters of credit backed by the government are a simpler way of doing that sort of business? Plainly no one is going to trust a cheque drawn on a local bank.

23. Russia/Eastern Europe Business and Finance Report, 15 February 1988, Vol 6 No 3, pp6, 7, 8.

24. Interfax, 25 February 1998, SWB 27 February 1998.

25. Finansovyye Izvestiya, 19 September 1996, p2, reported that internal Government debt had doubled, amounted to 630 trillion roubles. This was about 22.5% of GDP.

26. Obozreniye finansovykh izvestii, 5 March 1996.

27. SWB, 20 February 1998.

28. Rossiyskaya Gazeta, 18 February 1998, p6.

29. Pravda, 9 August 1997, p4 complains that the USA Budget is 17 times and Britain's twice as high, but this takes no account of differences of income, transfer prices of materials and therefore costs. Shlykov's monograph provides an interesting comparison.

In 1989 the official Soviet military budget was 20.2 bn old roubles, when the exchange rate was \$0.70=R1. On this basis the budget equalled \$15bn/annum. Even if the real figure was close to double, the Soviets maintained a parity with the West. Shlykov provides an interesting calculation by the USSR Academy of Sciences made toward the end of the 1980s. This showed that the military rouble bought between 3 and 4 times, at a minimum, more than the civilian rouble. This was easy to arrange simply by fixing much lower transfer prices for everything to military factories than elsewhere. But now this difference has gradually disappeared.

30. Shlykov, op cit.

31. This was repeated in the NATO seminar on resettlement and retraining of retiring officers held in Moscow early December 1997.

32. It is somewhat ironic to hear Russians quoting law, when the history of Soviet and Post Soviet Russia has shown that the law and the constitution have been conveniently

ignored when it suited the rulers. But now they do so to avoid carrying out a policy with which many disagree.

33. Nezavisimaya Gazeta, 31 December 1997, p2.

34. Kommersant Daily, 24 February 1998.

35. SWB, 20 February 1998.

36. For an interesting description of a large factory which provides an idea of the problems in Samara, an important provincial city, and attitudes of contemporary management see, Rossiyskaya Gazeta, 17 January 1998, p2, 'Better not to work than work'.

37. Details in this paragraph are from 'Troubled Lands, a Legacy of Soviet Environmental Destruction', D J Petersen, RAND Corp, Westfield Press, 1993.

38. A NATO delegation to Berlin was shown in 1996 the abandoned sites previously occupied by the Soviet Army and Volksarmee. The soil of those which had had tanks and trucks was now soaked in petroleum oils to a depth of two metres; there is no economical way of cleansing. The same must also be true with the fSU.

39. SWB Weekly Economic Report, S25, 20 February 1998.

40. Compiled from a variety of sources.

41. East/West Kommersant-Russia/Eastern Europe Business and Finance Report, 15 February 1998, Vol 6 No3, pp1-2.

42. My papers, obtainable from CSRC, relate useful experience. See 'Investment in Russia, 19th Century Lessons'; 'Rehabilitation of Russian Military Factories' etc.

43. The Moscow University of Economics and Statistics has produced a series of distance learning booklets for the western financed training centres for officers retiring from the Armed Forces. They are hardly to be recommended. For example the one entitled 'Fundamentals of Management' is in an old cast; management is defined as 'the organisation of production'. Not a word about marketing, design, quality, finances, profits etc.

44. For example, Russia/Eastern Europe Business and Finance Report, 15 January 1998, Vol 6 No 1, pp4-5, by E B Popp of Tirone Corp, Cleveland, Ohio, following a survey in 22 cities and interviews with 500 people.

45. 'The Golden Donors', Waldemar A Neilsen Dutton, USA, 1985. For other histories of philanthropists, see a) 'History of English Philanthropy, from the dissolution of the monasteries to the taking of the first census', B Kirman Grey, published P S King & Son, Westminster 1905, b) 'The Foundations, an anatomy of philanthropy and society', Ben Whitaker, published Eyre, c) 'The Rockefeller Foundation 1913-1950', Raymond B Fosdick, published Harper NYC, 1952. For a history of Russian Philanthropy, see 'Poverty is not a vice: charity, society and the State in Imperial Russia', by Adele Lindenmeyr, Princeton University Press, 1996.

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46. However John Lloyd, editor of the 'New Statesman', told me that Kakha Bendikidze, a wealthy Georgian has given a lot of money to support a children's hospital in Moscow.
47. BEARR Trust Newsletter No 22 March 1998. E-mail:bearr@gn.apc.org.
48. Professor Higgins in 'My Fair Lady', adapted from Pygmalion, by G B Shaw.
49. 'The British Empire as a superpower 1919-39', Dr Anthony Clayton, Macmillan, London & University of Georgia, 1986.
50. Research suggest that Roosevelt's New Deal, Civilian Conservation Corps and other means of getting America back to work did not take off until the rearmament programmes began to take effect late in the 1930s. In fact unemployment in USA was virtually eliminated only by 1943.
51. My reasons are partly that to do otherwise would be to lengthen the paper unnecessarily and also because I am more sure of my ground in the chosen area and because it will also be more familiar and therefore more illuminating to my main readership.
52. With the exception of industrial militancy amounting to sabotage by the British Communist Party which persisted until Germany attacked their spiritual homeland the USSR, when it became a just war. There were also some strikes and go-slow incidents in the old militant areas such as the Clyde and Tyneside.
53. One of the most convincing, seminal demolitions of socialism as a path to a politically and socially free and economically evolving society was set out in Hayek's book 'The Road to Serfdom', dedicated 'to the socialists of all parties', written in Britain at the London School of Economics 'in his spare time from 1940-43', by Professor F A Hayek.
54. The British Legion has evolved from its foundation at the end of the Crimean War of 1856.
55. 'The economic laws of scientific research'. Dr T Kealy, Addenbrookes Hospital Cambridge, CUP 1996.
56. See for example Maxim Gorky's autobiography, the trilogy 'Childhood, boyhood and youth' which was later 'sanitised' by the Soviets. He was not a supporter of Tsarism nor an uncritical one of the Bolsheviks.
57. This of course was also true in Britain until quite recently.
58. I am obliged to Charles Dick for this observation.
59. For example, the ethic of the good communist included one of identification of reasons for poor performance, social behaviour of individuals and efforts to stimulate them to activity that would increase their self respect. Some may say this amounted to interference but it undoubtedly had positive features. There was also respect for learning, personal achievement both real and as a masquerade in every walk of life. These were presented not only as a personal achievement but also as serving one's country. In principle this was no different from the award of an MBE to a Downing Street cleaning lady or a sub-postmistress after 40 years of devoted service in a remote

community or of an OBE or knighthood to a sportsman, popular entertainer, scientist or industrialist. Yel'tsin attempts to recreate this with awards for notable service to Russia. But the respect for everything but wealth has almost disappeared.

60. Yegor Gaydar, then lauded by the West as an economist who understood the market economy and could be trusted to inaugurate it, wrote a chapter in a book published in 1989 in which he wrote 'Soviet economics is far superior to bourgeois economics'.

61. People depended on the mutual self help of the extended family and on the produce grown on their country 'allotments'. Toward the end of the Soviet state, some private activity was permitted but much, such as that offered by doctors and dentists, went on in a largely tolerated grey economy. Many of the officials themselves used these services but the professionals knew they were at risk at any moment of denunciation with dire consequences.

62. For example in the late 1980s a professional engineer, doctor, manager or scientist might earn between 250-500 roubles a month depending on seniority; a tram driver, factory foreman would earn around 300, more than a new university graduate. Pensions varied between 30-250 roubles a month but there were significant additions for meritorious service, especially to the Party. Old age pensions guaranteed under the 1936 Stalin Constitution were not actually paid until the mid 1950s at the earliest.

63. One must mention Malenkov who succeeded Stalin in 1953; he advocated the switch from heavy industry to consumer goods. He was well before his time and was swept into decent oblivion to run a power station in Siberia. I am uncertain what other reforms he had or might have advocated.

64. Maj-Gen Thornwald, the Defence Attache at the Czech Embassy in London in 1995-96, observed to me that he had been a schoolboy during the German occupation; he learned that everything of importance had been invented in Germany, later under Soviet Occupation he had to learn that all those things were in fact invented by Russians.

The Present State of the Russian Economy

A Kennaway

SUMMARY & CONCLUSIONS

Some western observers of Russia seem to believe that having abandoned Communism, Russia must be proceeding along the road toward a democratic, stable market economy. This paper argues that this is not happening nor is it likely to happen. It describes the Russian economy, starting with the reforms that were supposed to lead to a thriving market economy, but which mostly succeeded merely to put in place the trappings and fashionable aspects of a capitalist economy and financial system. The principal effect of the reforms was to bring an already poorly performing manufacturing industry, agriculture and much else almost to a halt and in so doing to impoverish the mass of the people. Economic policies and aspirations of the Government are inconsistent, not to say contradictory. Most of the critical aspects of the real economy have not been improved. The paper attempts an explanation of why little or no credence can be given to the expressions of optimism, heard very frequently from her politicians over the past two or three years, that Russia is now on an upward economic path. Russia will remain trapped within its own peculiar, historical brand of arbitrarily determined chaos. It is not possible to predict its future except that the least likely path is one of approximation to our kind of economic, social and political order.

Economically speaking the progression from the dogmatic Soviet rigidities to the inchoate fumbling of Yel'tsin's rapidly changing cast of Presidential advisors and Ministers, hardly provides evidence for a belief in positive evolution. In Russia one has to modify Darwin's statement to 'Survival of the Fattest'. They are still adding to their personal wealth, to the contents of myriad decrees, orders and laws, without a strategy or a coherent policy. Ministerial statements always promise 'jam tomorrow, never jam today'. They rarely return to see if their promises have been made good. To an observer with an analytical bent it seems that jam does exist, but only as a log jam consisting of chaos created by muddle-headed decrees, laws and regulations created by Institutions of Government which are at loggerheads with each other. This paralyses the system and prevents consistent improvement in the economy.

What is the State of the Economy?

This is not easy to determine since the answer partly depends on the viewpoint of the respondent and the criteria he adopts. One could take the view of the financier and potential investor whose aims are to use the financial mechanisms, not in order to invest in the economy of a country and thereby to earn a capital gain and return on capital invested, but to speculate in the money market with the aim of a quick gain. From that point of view Russia indeed has had some attractions, more from the opportunities taken by Russians and their contemporaries in other successor republics to the USSR, than to westerners who can make money by taking much care and advice in an extremely risky market.

The events of July-August 1998 on the stock and bond markets of Russia expose the flaws in the financial policies of the Russian Government. The federal and subsidiary budgets of the Russian Federation are not like those to which westerners are

accustomed. Although they pretend to do so, they do not consist of the normal expectations for income and expenditure. Rather they hide an attempt to balance their indebtedness to their own people and to foreign creditors. They can only pay their internal current account debts by borrowing. The internal rates of interest are astronomical and therefore it is cheaper to borrow abroad. But since these credits are used to pay wages and pensions they do not improve the ability of the real economy to generate income. Therefore these debts will not be repaid. Furthermore the servicing of the mounting debt burden occupies a very significant share of the federal budget.

The picture looks even worse to those who measure the state of the base of an economy and its consequences on the life of the ordinary people. From the base, there seems to be little benefit from the government or from the manipulations of financial operations. These are almost totally different worlds.

One might, with only little exaggeration, attach three labels to the Soviet Union:

1. A country in which hardly anything was required to be done, nor indeed was done, professionally and thoroughly and certainly not in a manner that is financially self-sustaining, let alone profitable in a true sense. Projects were rushed, using poorly performing materials and components, in the interests of short-term completion, often for prestige reasons.

2. A country, which in spite of its claimed high standards of science and technical education, failed to design, make and service the equipment and systems required to put in place, maintain and develop a modern infrastructure, production and manufacturing system, agriculture, medical services or scientific laboratories. Practically all of those engineered products were either imported, made under licence or on bases acquired by dubious means from abroad.

3. A country which paid for imported technology by the sale of minerals, semi-finished raw materials and, often enough, also food that the populace stood in need of.

The collapse of the USSR has exposed all this. It has led to insatiable demands for credits and foreign investment to fill the needs of quite basic equipment and to repair the appalling state of the infrastructure and the basic sinews of the economy. In fact matters have worsened in spite of, or, as some would argue, because of the "reformers". Russia now imports around half its food consumption; without basic equipment and expertise the essential infrastructure of transport will deteriorate still further. This will have a negative impact on exports of bulk freight. Pollution and spoilage of the environment, misuse of agricultural land will accelerate. Further devaluation of the ruble will severely reduce income from oil, gas and other minerals. This income in any case is further reduced by the lack of skill in foreign trade. Similar lack of skills in design, commerce and plant operation will continue to depress the performance of manufacturing industry. There are few signs that Russian managers are acquiring an understanding of these professional matters. Their best chance is to learn by close collaboration with world-class firms and personnel.

Foreign firms see their main chances of earning sustainable income and profit in the fields of oil, gas, food processing, packaging and tobacco products. Outside these areas foreign investment is negligible and confidence in those areas will continue to weaken in view of the resistance to and suspicion of well proven methods abroad. Furthermore the efforts of the wealthy Russian institutions and individuals are

directed to rapid personal enrichment to the exclusion of investment in the essentials of their own national economy. Such people are indifferent to the needs of the ordinary Russian people, whom they regard as irrelevant. This attitude pervades government at every level. It is not encouraging to serious, long-term, foreign investment.

It is also important to remember that the visible signs of prosperity for some in Moscow and St Petersburg are *sui generis*; the provinces and above all the countryside where the majority of the population still live are in a far worse position. It is no exaggeration to say that outside a radius of perhaps one or two hundred kilometres from the main cities, the population is still living in circumstances resembling those of the turn of the 19th/20th centuries.

Russia, at best, will during the next decade continue to muddle along and thus its economy will also continue to deteriorate.

An Explanation of the Economic Realities

Let us start at the level of macro-economics and work down to realities.

Because the exchange rate of the ruble has been, since July 1995, pegged within a corridor of gradually crawling deterioration against the major foreign currencies, it has been possible for Russians and foreigners to deposit roubles, take them out again after 6 or 12 months, gain about 8-10 times the interest that is available in stable western currencies and then exchange the roubles with around a 9% loss compared with the initial rate. This has attracted 'hot foreign money' as well as that of some of the Russian population. Gains are immediately exported; they may or may not have paid tax; this depends on 'blat' - whom you know and who can fix it. The Russian Central Bank does nothing to prevent this outflow; it seems to regard the foreign money as having a bad effect on the internal money market. None of this money benefits the economy since it is not invested by the banks, who also speculate with it, or by the recipients. The flight abroad of money has been phenomenal; successive Finance Ministers have made their own estimates. Fedorov, when he was Finance Minister gave it as \$200 billion and one of his successors stated that a further \$50 Bn have been added since¹. 'What is sure is that the outflow, in addition to diverting funds required for domestic investment, means the government receives no taxes on it.'² On February 1st 1998 hard currency reserves, used to back the ruble, were down to \$18 Bn; a loss of \$6Bn in just one month. Russians are also hoarding, according to various official estimates, between \$40-70 Bn not deposited or invested in any financial institution³. This is greater than the value of rubles that they hold. However no one trusts the banks and there is no reason to believe that any such funds would end up where they would benefit the country rather than some highly placed officials.

There are, as yet, no proper means of valuing land⁴, industrial buildings, equipment, other fixed assets, profits, or indeed income and expenditure, reserves for contingencies, creditors and debtors, costs of production or any elements essential to financial assessment and prognosis. It is noticeable that wise western audit firms often state that their audit of firms in fSU, including the Baltic Republics, is based on the statements of the directors, ie the convenient fiction of the moment.

The State Committee on Statistics (Goskomstat) published figures for 1996 showing that household expenditures included the purchase of considerable amounts of

foreign currency. The figure rose regularly from 13.5% of their total expenditure in January to 21.7% in December and is still rising. Plainly, in spite of the government's wishes and decrees against the use of foreign currency for internal trading, the population still regards it as a useful precaution. This fact suggests that the low level of purchases of consumer goods made in Russian factories is not due to lack of money; that part of the population that can do so prefers to save rather than spend.

Since it became legal to export hard currency, the Russian press has been full of examples of purchases of land and property in desirable places abroad. These places include London, New York, Bermuda, Spain and Cyprus as well as the Arab Middle East. The New Russians, as the seriously rich are called, have acquired wealth rapidly in various ways which would be condemned in the West, at least in law. Their operations in tax havens seriously worry western Treasuries because of their effect on our money markets, especially in laundering money.

This outflow of money occurs simultaneously with requests by Russia for large loans from the international and national financial institutions. These are used to pay Government debts on current account, not for investment in projects that would revive the economy, earn a profit and thus repay the loans and credits. It is beyond belief that Russia will ever repay the credits and loans advanced; they are constantly being rescheduled. The loans should be unnecessary if the Russian Government had put its financial and economic house in order. Some commentators argue that Western loans are simply encouraging profligacy. As we shall argue below, the Russian leadership is incapable of, and indeed unwilling to, take the steps that would lead to a genuine improvement in the economy.

Foreign investment in the genuine economy is vital but is unfortunately not large. One has to compare optimistic statements by Ministers and other economic commentators with facts. These show that foreign capital investment in Russia is below that of some other, much smaller, central and east European countries. It is not easy to determine a fact in Russia; even the same Minister is prone to giving widely differing figures. The best that the objective observer in search of truth can do is to provide a probable range. Chernomyrdin reported:

*"In 1994 foreign investment was only \$2Bn; in 1996, \$2.8Bn and the total to the end of 1996 was \$8.5 Bn. Investors rank Russia as 200th in a league table of desirable countries for investment."*⁵

Other sources give even lower figures: Foreign investment in 1994 was given in December 1995⁶ as \$1.0 Bn. It was, furthermore, very unevenly distributed; half went into energy companies, only 4.1% into engineering. Some regions benefited considerably whilst others not at all. Foreign investing countries are reported⁷ to be USA 29.1%; EU 32.7%; Switzerland 15%. The EU additionally gave Russia ECU 1.5 Bn over 1991-95.

Real incomes are now some 40% below those of 1990. Average per capita figures across the country in 1997 were R829,600 (\$150). But in many provinces the figure was around half that, with higher cost of basics partly due to the isolation of the areas. Goskomstat figures for 1996, derived from a household sample, showed: between 30-36% of the population, 20.2-24.2 million people, in 1996 lived below the official poverty line and 9-12.7 million, ie 6.4-8.6% of the population, could not afford to buy the minimum food basket. This varied across the country; conditions in Moscow or St Petersburg do not reflect the life of ordinary people in the far countryside depths of

Russia.⁸

The Government claim credit for the reduction of inflation to present levels. It is arguable that this has been achieved as a consequence of the drastic reduction in demand and by the reduction in economic activity to very low levels.⁹ We may also observe two other financial factors:

* the enormous debts of the state accumulated in unpaid wages to state employees, including the military. Government debts may amount to 25% of GDP. The pensions funds, together with funds earmarked to pay unemployment benefit have been raided and figure in what are called 'non-budgetary funds' which are used to pay current items including those other than for their intended purposes.

* the circulation of pseudo-money, in the form of IOUs, for example to energy companies by State administrative organs as well as by nationalised industries and also by private persons. These IOUs are used in trade, heavily discounted, as if they are money.

Government Income

The 1998 Federal budget intends to spend just under 500 billion NR, 17.7% of GDP; to raise NR 368 billion, keep inflation below 5.7% for the year. GDP is predicted to be NR2840Bn. The Government asserts that it could pay its debts if only it could collect the taxes due it. In 1997 it collected 611Bn NR for federal, regional and local governments; this was 98% of the target and 32% more than in 1996, according to Pochinok, the head of the tax service.¹⁰ Of that 267.2 bn was for the federal budget, 37% more than in 1996. He reported that only 55% was collected in cash. He did not say what the rest was paid in. It may be that taxes due were offset by debts owed to the enterprise by the government. In 1998 the task would be to collect all taxes in cash. Deferments in tax due would not be tolerated. His target for 1998 was to collect NR265Bn - a surprising reduction on the previous year!

But these figures have to be compared with those produced by his colleague V. Popov the head of the department responsible for collecting tax arrears.¹¹ The total amount owed to all levels of government is NR 554.9Bn, of which NR 297.9Bn is owed to the federal government. If these figures are true, the only way to reconcile them is to assume that arrears dated from before 1997. However Yel'tsin's economic adviser A. Livshits - recently dismissed - is doubtful if the tax collection reached anything like the claimed figures. According to Dr V. Shlykov¹², a former deputy chairman of the State Committee on Defence and an expert on the military budget, the current tax code consists of 1200 'poorly coordinated or utterly contradictory presidential decrees, government orders and ministerial instructions, plus around another 3000 acts that refer to tax norms'. Businessmen and others complain that the tax system is chaotic, often punitive to honest business and therefore invites tax evasion.

The Soviet economy was not based on money. Firms did not pay taxes; the State simply appropriated the 'profit' ie difference between the input costs as set by the State and output prices which were also set by the State; there were at different times varying amounts of retentions and bonuses allowed to the firm, but this did not alter the fact that firms were not accustomed to paying taxes as such. There was at some time in the soviet period, especially the last decades, a graduated income tax for individuals; but this was a very small part of total income and again, work done 'with

the left hand', moonlighting, was never declared or assessed. People became adept at working for themselves outside the system, partly to get more money and partly because they were fulfilling a need which the State was unable to supply in a manner satisfactory to the customer. This included dental work above the standard prescribed, private lessons, repair of cars etc. Ministers at various times have estimated that the grey and black economy, neither of which declares its income or pays taxes, is responsible for between 30-50 % of GDP. The continuing non-payments of accounts due results not only in the use of IOUs¹³ but in the continuation of the old barter trade between soviet firms, republics, regions and also in foreign trade. This barter trade pays no tax, no VAT. How is it to be assessed or stopped?

Just as the putative tax payers were unfamiliar with taxation, so were the tax authorities. They rushed into a tax code which was riddled with anomalies, created a load which prevents any business run totally honestly and in accordance with the tax code to be profitable. Most variants demand as tax between 60-70% of the total income of a company, let alone profit. Some demand more than the total income of the firm. Consequently there is widespread tax evasion and late payment. A recent introduction is that of a special tax police. They are not specialists in financial matters, indeed some are retired army officers. It is unlikely that such people will outwit criminals or determined tax evaders.¹⁴ Successful foreign businessmen say that the tax police descend on them, make life a misery and only go away when a bargain acceptable to both sides is struck after much misery and disruption of business. This is not unknown in some western countries for example Italy. No wonder that the press is full of complaints and that the Federal Council and Duma are constantly seeking revisions to faulty legislation.

Sharing the Income

The Federal Government is not the only organ of State in need of income. This is true for Republican, Oblast, Rayon and City authorities as well. In the past the Central Government and Central Committee of the CP doled out funds to these bodies; the shares were the result of much lobbying, cronyism etc. This is still the case with some differences. The lower organs have the job of collecting the taxes and transmitting the share due to the Central Government. But things are a bit different now in that the lower organs get it first. This gives them some leverage.

The economic health of the different regions in the Federation varies enormously. The basic resources, the degree to which they are being exploited and to whose benefit, the ability to fend for themselves or otherwise are significant factors in the economic stability of the Federation. Many regions are now inhabited by bankrupt organisations which derive very little income from their proper work. It is frequently stated in high government circles that about half of all commercial enterprises in the Federation are bankrupt, but few if any have been put into liquidation. Such firms are still responsible for paying their workers, and continuing to provide them with the social services to which they were accustomed. These include company owned flats, creches, hospitals, first aid clinics, canteens, subsidised shopping. That is why workers do not leave, still appear on the books even though their pay may be months late. This partly explains the low official unemployment figures.

In practice Moscow City pays nearly 25% of the total income of the Federal Government and 60% is paid by only nine 'constituent parts of the Federation' according to Pochinok¹⁵. Only 23 out of 89 regions contribute; the rest are a drain on

the economy and the Federal budget.¹⁶ The Federal Government is in constant negotiation with the richer republics within the Federation, regions, etc. The viable republics and regions have become more powerful in their dealings with the centre; some feel that Moscow does nothing for them so they do their own deals in foreign trade. For example Sakha sells diamonds direct. Gazprom is reliably reported to pay 25% of the taxes due to the federal budget, but only 8% of that is in cash; they provide the rest in services which offset their tax due. The Federal Council, the upper house of parliament, represents the interests primarily of the regions and therefore is becoming more powerful than the Duma.

The Problem of Non Payment of Accounts Due

As we saw above, the Soviet internal commercial system was basically one which did not require money to pass for transactions between commercial organisations or between them and the State. Trade was accounted for by book-keeping entries and much of it was done by barter. When the Soviet Union collapsed so did this system of central transfers of book entries. When it became clear that the State itself was bankrupt, the factories and collective farms etc did not stop work entirely or suddenly. The railways and other means of transport continued to function. This was a bit like the nervous reaction that propels a headless chicken to continue to run, that is if money is seen as an essential lubricant of trade. However, people brought up in a soviet system did not necessarily share that view; real life could function as it did before without money. Some factories continued to produce for want of anything better to do, the defence industries and many others simply made for stock, waiting for the State or other organisations to take the goods off their hands. When they ran out of components, they, as of old, paid the suppliers in goods¹⁷ or in IOUs. Even Gazprom admits that in 1997 it collected only 38% of payments for gas. But it also traded IOUs from customers. The factories had no cash with which to pay their work force; so they were reduced to paying workers in kind. This process has expanded considerably to the present day. It must be tough for workers in factories that make things that are harder to sell.

Barter trade between enterprises and even governments is common. Much import carried out under barter consists of raw materials. Lukashenko, President of Belarus, spends much of his time fixing and signing barter deals with his opposite numbers in Kazakhstan, Uzbekistan and others within the Russian federation such as Siberia. Barter trade, of course, avoids paying taxes, especially VAT. A recent report¹⁸ estimates that 80% of Russian firms are involved in barter trading. The author suggests ways for foreign firms with Russian partners to monitor this trade, which can cost them dear.

On the one hand the State loses from barter trade but on the other it gains, from non-payment of accounts, since as a major debtor it pays late with devalued money. Debtors can hold on to money, which they invest, earning high interest rates, as we have seen above. So it is on balance probably beneficial to the main debtors, such as the state, in all its forms, banks and commercial houses to continue with the present methods of trading. As at 1-1-98, it was reported¹⁹, companies in industry, agriculture, transport and construction owed 782,200 Bn old roubles (about \$130 Bn). Until the economy is running normally, with goods bought and sold through the normal mechanisms of a market economy, on a regular basis of confidence in prices and payment, it is unlikely that a conventional monetary system will come about. There is much discussion by government, which claims it is determined to solve the

issue; it is setting up special commissions and study groups to solve the problem. No progress is made. It is not in the interests of the debtors to solve the problem of non-payments of debts. Since the Government²⁰ and the banks amongst other commercial houses are the main debtors, and have close connexions with senior politicians, it would seem unlikely that the talk about solving this problem will be translated to effective action.

Privatisation and Corruption

Finansovyye Izvestiya²¹ gave the following analysis of small business activity at the end of 1995.

1	Construction	31%
2	Industry	28%
3	Foodstuffs	25%
4	Others	10%
5	General commerce	4%
6	Research and services to research	2%

The article comments, probably accurately, that small businesses are highly innovative and hold out a promise for the future.

A total of 126,785 firms, 58.9% of all state owned firms, have been privatised to date, according to Braverman²², the first deputy head of the State Property Ministry. In 1997 sale of 3,353 firms raised 18,653.5 Bn old roubles. He added that in 1997 over 75% of a GDP of 2,675 trillion old roubles (billion NR) was contributed by the private sector. This proportion is disputed by other officials; it is likely to represent trading, especially by the giant energy near-monopoly firms such as Gazprom and Lukoil, rather than manufacture or agriculture. What the figure does suggest is the appalling losses made by the State owned manufacturing firms and infrastructure.

The system employed in Russia was the worst possible. The population was given vouchers with which they could buy shares in a company that was to be sold off, or to put toward a flat. The theory was that all state property belonged to the people and should be given back to them individually; a nice idea but it did not work out that way. Vouchers could be traded. What happened was that the then directors of lucrative state enterprises and other top people managed to buy a controlling packet of shares. They knew what would make money quickly and who to associate with. These people bought the only segments of the economy that could produce vast income, namely gas, oil, mineral, timber extraction and distribution, scrap metal and semi-finished steel products for export. The heads of the old firms are now at the top of the Federal, Republican, Regional and City Governments. In this way governments of Russia and Republics such as Kazakhstan are run by the seriously rich merchants who have captured power. The method was emulated all the way down to individual factories, whose directors can exercise undue influence over government policy at Republican and regional levels. Furthermore they have taken every opportunity to cream off the assets of even poorly performing factories. The press is full of examples of blatant public corruption.

The Budgetary Process

Year after year the Federal Budget is constructed on a mixture of hopes and fantasies

which must strike even the authors as unlikely to be fulfilled. Its purpose is to present a picture that will satisfy the various interest groups that the government is looking after them and at the same time pretend to the IMF, EBRD etc that the government is embarked on a path of financial prudence and probity which is leading to international recognition of their financial respectability. But budgeted incomes are not achieved nor are the expected and promised expenditures. No one is or should be fooled. The Duma will not throw out a draft budget too often nor defy the Government on major issues. The Government in such cases is entitled to dissolve Parliament. The delegates would not like this since they will lose their not inconsiderable personal privileges, in addition to similar perks in their home locations.

Defence

Defence still figures as the largest individual element in the Federal Budget, to which must be added elements of the expenditures of lower level authorities. The official federal defence budget amounts to 3.5% of published GDP for 1998 and 1999.²³

It is also true that budgeted sums do not necessarily get paid. Only half of that due reached the MOD in first three-quarters of 1996 and 1st quarter of 1997. However true defence budgeted expenditure probably lies between 8-12% of GDP if one takes into account:

* items excluded from the budget but which lie within NATO classification of defence expenditure.

* Expenditure by republican, regional and city authorities which may or may not be covered by the Federal Government.

* Expenditure on Armed Forces not reporting to the MOD but to about another two dozen ministries. In addition there are items paid by 'non-budgetary sources' and expenditure, often hidden, on military projects as 'science, research and development'.

Industry and the Environment

With 70 years of an agenda of excessive militarisation of the country, which denied adequate resources to every other activity, an autocratic, centralised leadership that demanded volume and speed of performance in every project, it will not be surprising to learn that industry, apart from the Military-Industrial Complex, agriculture and all the transport and communications infrastructure is well below the standard of design, manufacture, maintenance and operation that is expected in advanced industrial countries. And so it is. It must not be thought that Russian managements do not have objectives; they did and still do. But Soviet objectives were primarily to fulfil the quantitative elements of the Plan; now, to fulfil orders from anyone, and secondly to produce within the demanded time scale. Nothing else figured. All these sectors have been starved of investment for decades; much of what has been provided has been misapplied and in the case of some modern imported kit, misused. Factories are usually badly laid out; the storage and handling of materials and work in progress is lamentable and wasteful; energy utilisation many times that experienced in the west; unsafe practices abound. The number of fatal accidents per 1,000 workers is about 12 times the British average over the years 1991-96. One miner was killed for every million tonnes mined in Russia.²⁴ The lost time accident rates, which in Britain are monitored and the subject of much management activity to reduce them is not

recorded in Soviet or Russian figures given to the International Labour Office. The upshot is low productivity, high reject rates of product, variable properties of engineering materials and lack of a proper range of many of them. Agricultural output shows that output per person employed and per hectare sown is about 5 times less than in climatically comparable States of USA, and about ten times less than that of Denmark and Britain.

The reluctance of the hierarchy to abandon or drastically reform the manufacturing sector is seen at its worst in the Military-Industrial Complex. But it is also felt in every state owned sector, which still consumes enormous subsidies, employs millions and produces little that is saleable.²⁵ Mercifully, as seen below, a few foreign firms, as well as some bright, sensible young Russians who worked in the State defence factories, are founding small scale industry from whose example eventually major manufacturing practices may improve.

The effect on the environment of this frenzied but poor activity is catastrophic.²⁶ To give a few examples: most cities, even St Petersburg and Moscow, have insufficient effluent treatment stations; raw sewage pollutes the water table, the local rivers, seas and lakes. This is in spite of the decrees giving production of clean water a high priority between 1976-88. There are strict laws but they remain mostly on paper. According to a Russian environmental expert, Yablokov, oil seepage into the ground and water amounts to between 7-20% of all oil produced, the variation is between regions studied.²⁷ In my own experience, in purchasing foreign 'turnkey' factories, in many cases Russians omitted the environmental and also safety features to save money. Non-fulfilment of the Plan had more serious financial and other consequences than ignoring environmental norms.

UNESCO reports that the Baltic Sea is the world's most polluted, in the Black Sea bacteria levels are 200 times higher than world norms and is regarded as dead by UNESCO. But, on the credit side, the emerging Green Movement did have some effect in late Soviet times, stopping some of the stupidest, least effective and most harmful projects. They may do so again. The situation has worsened since the collapse of the USSR. As a result, people are increasingly suffering from respiratory diseases and those of the internal organs, heart and cardio vascular system. To put right the failings of the past will involve billions of dollars that will, inevitably, be diverted to projects considered more important, but also required is a radical training programme for all managerial, scientific and technical personnel to enable them to perform to international norms. Unless this is done new projects will be no better than those from the past; present operations will continue to present hazards. There is no indication that such policies and actions figure in the budgets of the Federal or of other governments in the Russian Federation. Things therefore can only worsen.

Communications

More and more contracts are being awarded to foreign firms to re-equip telecommunications systems. The railway system is also creaking; it needs much investment. The economy of Russia stands or falls by the railway system, which carries a greater share than any other in the developed world of heavy freight; there is little consumer good freight and passengers also form a small proportion of total income. Average speeds are low by western or Japanese standards. Railway management has had many dedicated, professional staff but the system is slow, badly in need of investment for maintenance and development. Most of the required

equipment has to be imported. Heavy freight takes priority and passenger transport has to be held in lay-by loops to allow it to pass even on main trunk routes. There has been much talk of prestige, high-speed train services, for example between St Petersburg and Moscow. Such ideas are typical of Russia: firstly priority should be given to upgrading the existing services, secondly the demand is overstated, thirdly the marshy terrain requires considerable civil engineering work.

The air transport field is already heavily reliant on the use of foreign airplanes; Soviet planes are neither economical to run or indeed safe enough to command respect. Some of them have aerodynamic deficiencies, all their engines have a short life and are fuel guzzlers. Soviet-era airfields and airport terminals are also primitive and require modernising in communications, radar, air traffic control systems, and adequate, modern means for handling cargo and passengers. This is already happening, with western money and using foreign equipment and contractors. The management of the transport system is undergoing much reorganisation but also has much to learn from abroad.

Road transport is also inadequate; the main roads are not too bad; however their surfaces last only a short while since the bitumen is brittle and cracks under loads. The advent of foreign trucks with much higher axle loadings than those used locally will aggravate this defect. It is also reported that maintenance of the road bridges has been neglected for years and that much expenditure is needed to bring them to a safe working condition. The equipment required has to be imported. Foreign firms are investing in badly needed service stations along the main routes, especially those leading to the west and the Baltic States. A new ring road is planned for St Petersburg; the present cluttered roads carry a considerable volume of freight across the Finnish border. Much remains to be done to get border clearances to work with acceptable delays and practices. A recent report²⁸ details problems. The courier firm DHL is quoted as saying 'customs officers, who often see themselves as police rather than facilitators of the economy, should be educated about what business needs.' It added that a lack of resources and low pay lead to an untrained, unmotivated corps of customs officers.

Unemployment

Official figures claim a modest proportion of unemployed people, around 7% of the work force. However the real figures are several times higher but are cloaked by several facts.

* As was pointed out above, many workers are reluctant to sign off their current place where they are registered for work in their 'working passbook' even though they may be offered little or no work and may be either on unpaid leave or receiving their salaries several months late. This is because they have benefits in kind. They are effectively idle.

* Others may be 'moonlighting' or working in the grey economy, which amounts to a significant share of the national economy; some senior members of government and commentators from Institutes that 'study the economy', say around 50%.

* In any event the productivity of workers everywhere, in factories, fields or offices is low; every branch of civil and military activity is overstaffed.

The State job centres run by the Labour Ministry are beginning to get into gear, to find

jobs for people, but they are underfunded and unemployment pay is not enough to provide even a subsistence existence.

More encouraging is the growth of a new middle class, who are mostly young. Those with good English and computer, financial or legal skills earn well, around \$1,000-2,000/month in service industries whether foreign or Russian owned firms. Medical doctors, surgeons and dentists can legally work part-time for a pittance in the State system but can earn larger sums in the private sector on a part-time basis. Older people, for example those with sound administrative experience and who can rapidly learn how privately owned firms work, also do well, but mostly in service industries. There are some who have become entrepreneurs or directors of small-scale manufacturing firms, which are regrettably not too numerous. Such people succeed in the small but growing number of firms set up or jointly managed and owned by foreign firms of high calibre. The joint ventures lie mostly in extraction and distribution of oil, gas, minerals and timber. Foreign firms have been successful in food processing, packaging, tobacco, construction and building and increasingly in pharmaceuticals and medical services. The future of Russian industry must rely on Russian engineers, scientists, managers and the work force learning from the best practices of foreign firms.²⁹ This can only be done in the firm, by example, and that relies on the foreign partner retaining control. The fashionable methods of classroom learning in Business Schools or worse, distance learning³⁰, are not a substitute for learning on the job; these methods may, if they are soundly based and work closely with actual practice, provide a useful understanding of how things are supposed to work. Some reports³¹ emphasise the number of private firms in Russia, their rapid growth and the claim that 40% of all employees work for them. In my view these statements are misleading. How many of them are in manufacturing and how many trade usefully to the economy? One suspects that many are shell companies engaged in 'services'.

Social Services

The old Soviet order has collapsed. Pensions are derisory and usually paid late. The Government accuses regions of paying pensions and wages by withholding taxes due and threatens to deny them federal contributions if this continues. By law all employers are obliged to pay a proportion of the wage bill to a pension fund; the state is still the largest employer but ignores its own law. It uses IMF and other loans to pay current account debts of this sort.

The free State medical service is now badly run down and understaffed. Many doctors and paramedics moonlight quite openly in private clinics. The condition of even the best hospitals was poor in the last Soviet years, now they must really be struggling. The Soviet pharmaceutical industry was never adequate, either in the range or quantity of products available; it is worse now. Foreign medicines are imported in large quantities and at high prices. As a result health care is increasingly unavailable to pensioners and those at the bottom of the income pile.

Every report points to worsening health, increased use, especially amongst the young of drugs and alcoholism, the traditional scourge of Russia, is increasing in every class and age group. Due to these factors, to poor public health, to polluted water and air, to poverty, to a sense of helplessness and an embrace for every kind of degeneracy spawned by TV advertising, to the poor conditions of prisons, a general decline in health is reported. The expectancy of life has over the past ten years dropped by ten years. The Military Commissions report that over a third of those presenting

themselves for military service at 18 are rejected due to poor health and that a third have already a criminal record. Venereal diseases were almost absent in the last decades of Soviet times; so much so that it was difficult for medical students to become acquainted with their symptoms. They are now again rife; dysentery and TB are now again endemic, as is cholera in many regions and cities. Social morality is also weakening; there are more abandoned children.

Conclusion

In sum, the flawed inheritance of the current regimes is exacerbated by the key errors of their western economic advisers, whose mistakes are due to ignorance of Russian realities. This also provides the basic reasons why Russia is not likely to escape its present muddle, chaos, in-fighting between ministries, conflicts of policies and decrees, its present stagnation of the sinews of the economy, its increased reliance on export of raw materials and purchase of foreign technology from electronics and modern cars and airplanes, even to quite basic run-of-the-mill technology and increasingly not only basic foods but luxuries such as foreign vodka, bottled mineral water and soft drinks. There is little attempt to improve the ability to design, make, service and market things like this independently. There is only talk of import substitution. With everyone's eyes on the top, on such things as a stock exchange and floating Government bonds abroad, no real attention is paid to things at the base of the economy.

In these circumstances, one cannot predict even a modest incremental advance to the kind of society in which honest businessmen will feel comfortable. They may, with difficulty, learn to flourish. The mass of the population cannot look forward to maintaining their present, miserable existence let alone look with confidence to a significantly improving economic future for themselves or their families.

ENDNOTES

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1. There are other, more sober estimates. 'Trud' published various estimates of capital flight since 1991 and made it \$60-70 BN. Deutsche Morgan Grenfell thought the 1996 figure alone was \$22.5 BN and the Russian Central Bank gave \$8 BN.
 2. Inside Russia & the fSU, European Press Agency (EuroPA), 16 February 1998.
 3. G Lisichkin in Rossiyskaya Gazeta, 24 December 1997, p3.
 4. The city of Saratov held the first land auctions in the RF on March 5 1998. Plots sold many times above their starting price. BBC Summary of World Broadcasts (SWB), 5 March 1998.
 5. Quoted by D Kirillov in Finansovyye Izvestiya, 30 January 1997.
 6. Yu Yakovets, Finansovyye Izvestiya, 21 December 1995.
 7. Segodnya, 6 February 1997, p2.
 8. For example an article in Central European Economic Review, February 1997, p29,

by Elizabeth Williamson on her journey on the Trans-Siberian railway explains a lot; the farm labourers earning \$40-80 a month, the 'shuttlers' of Russians and of all nationalities including Mongolian traders smuggling cheap goods from China into Russia, bribing the train staff and customs officers. A book worth reading, also by an Englishwoman, is about life in an urban provincial city on the Volga. 'The little Tenement on the Volga' by Caroline Walton, 1993/94.

9. For a thorough discussion on economic matters especially on inflation and the industrial collapse see 'Assessing Russia's economic situation at the beginning of 1997', Jacques SAPIR, Directeur d'Etudes à l'école des hautes études en sciences sociales, Paris.

10. SWB Weekly Economic Report No 526, 27 February 1998.

11. SWB, 27 February 1998.

12. 'The crisis in the Russian economy', V V Shlykov. Strategic Studies Institute US Army War College, 1997. [Http://carlisle-www.army.mil/usassi/](http://carlisle-www.army.mil/usassi/).

13. IOUs are traded at a significant discount; the current rates for those issued by 'respectable firms' are quoted regularly in Finansovyye Izvestiya. They range from 20-80%. As a result the price set by the seller to a buyer offering to pay in IOUs is raised to compensate.

14. I travelled in a soft coupe a couple of years ago with the retired general i/c this outfit. We had an illuminating night time discussion. I did not come away confident in his ability to collect due taxes or to avoid corruption amongst his officers.

15. SWB, 27 February 1998.

16. Rossiyskaya Gazeta, 18 December 1997, No242 p3 gives a table from January-October 1997. Total in to federal budget 157,386,466 Mn R. Out 23,607,969.9 MN R.

17. I was present when, few years ago, three Kazakhs burst into the office of the general director of the Minsk Tractor factory and yelled 'where are the tractors you promised us?' The director calmly replied 'you will get them when we begin to receive the shipments of grain you promised'. With that the conversation ended. Surely letters of credit backed by the government are a simpler way of doing that sort of business? Plainly no one is going to trust a cheque drawn on a local bank.

18. Russia/Eastern Europe Business and Finance Report, 15 February 1988, Vol 6 No 3, pp6, 7, 8.

19. Interfax, 25 February 1998, SWB 27 February 1998.

20. Finansovyye Izvestiya, 19 September 1996, p2, reported that internal Government debt had doubled, amounted to 630 trillion roubles. This was about 22.5% of GDP.

21. Obozreniye finansovykh izvestii, 5 March 1996.

22. SWB, 20 February 1998.

23. Marshal Igor' Sergeyev, press conference, reported in SWB SU/3305/S1/2, 14 August

1998.

24. SWB, 20 February 1998.

25. For an interesting description of a large factory which provides an idea of the problems in Samara, an important provincial city, and attitudes of contemporary management see, Rossiyskaya Gazeta, 17 January 1998, p2, 'Better not to work than work'.

26. Details in this paragraph are from 'Troubled Lands, a Legacy of Soviet Environmental Destruction', D J Petersen, RAND Corp, Westfield Press, 1993.

27. A NATO delegation to Berlin was shown in 1996 the abandoned sites previously occupied by the Soviet Army and Volksarmee. The soil of those which had had tanks and trucks was now soaked in petroleum oils to a depth of two metres; there is no economical way of cleansing. The same must also be true with the FSU.

28. East/West Commersant-Russia/Eastern Europe Business and Finance Report, 15 February 1998, Vol 6 No3, pp1-2.

29. My papers, obtainable from CSRC, relate useful experience. See 'Investment in Russia, 19th Century Lessons'; 'Rehabilitation of Russian Military Factories' etc.

30. The Moscow University of Economics and Statistics has produced a series of distance learning booklets for the western financed training centres for officers retiring from the Armed Forces. They are hardly to be recommended. For example the one entitled 'Fundamentals of Management' is in an old cast; management is defined as 'the organisation of production'. Not a word about marketing, design, quality, finances, profits etc.

31. For example, Russia/Eastern Europe Business and Finance Report, 15 January 1998, Vol 6 No 1, pp4-5, by E B Popp of Tirone Corp, Cleveland, Ohio, following a survey in 22 cities and interviews with 500 people.