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DILEMMAS OF RUSSIA'S MODERNIZATION

В статье В.Л. Иноземцева «Дилеммы российской модернизации» представлен опыт современной России, экономика которой уникальна, поскольку единственная в мире не базируется на развитии промышленного производства. Анализируются причины, обусловившие подобный промышленный спад. Вследствие этого провозглашенная сегодня политиками и экспертами российская модернизация не имеет, по мнению автора, шансов воплотиться в жизнь по целому ряду обстоятельств, представленных в статье с соответствующим анализом и комментариями. Это обусловлено прежде всего тем, что в течение последних 20 лет общероссийская политика не была направлена на защиту интересов страны. Российские политики думают и действуют как бизнесмены, а там, где власть становится бизнесом, речь не идет о модернизации.

Пути преодоления сложившейся кризисной ситуации требуют проведения целой системы мер. Модернизация в России должна начинаться прежде всего с реформы ресурсно-промышленного производства.

Автор выделяет причины, по которым перспектива модернизации России в ближайшие годы кажется совсем нереальной.

1. Сегодня России недостает взаимопонимания относительно модернизации между народом и политической элитой. Российская экономика сохраняется как классическая рантье-экономика, базирующаяся на обширных природных ископаемых, а не на талантах своих граждан и возможностях собственного промышленного комплекса.

2. Само восприятие модернизации в стране кажется также устаревшим, основанным на убеждении, что модернизация может быть достигнута через технические нововведения, инновации, а не через глубокие социальные, экономические и юридические изменения.

3. Существующая в стране беспрецедентная связь между бизнесом и государственным аппаратом делает, на взгляд автора, любые промышленные реформы необязательными и даже опасными для самого верхнего эшелона власти, высших кругов государственного правления.

4. «Вертикаль власти» слаба и не в состоянии перевести свои решения в область практических действий.

5. Российская элита не видит возможностей проведения модернизации своей страны как процесса включения ее в глобальную экономику; она все чаще оказывается орудием противостояния «внешнему миру», изображаемому как враждебный и неблагоприятный по отношению к России.

Вот почему, несмотря на то, что сегодня многие люди в России верят, что нет другого выбора, кроме модернизации, автор статьи считает такую постановку вопроса просто риторической.

Russia today stands unique among major powers as the only economy which hasn't capitalize on industrial build-up in recent 20 years. While China expanded its industrial production 4,3-fold in 1994–2008, India advanced it by 2,1 times, and even Brazil developed a solid industrial ground for its future, Russian industrial production today stands well below where it was by the end of the Soviet

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era. Its «colleagues» from BRIC exported \$1,42 trillion in industrial goods last year, but Russia's industrial exports were a mere \$32 billion. Only 16 per cent of Russia's workforce is engaged in industrial sector these days with the workers employed being 6.7 times less productive than in the United States.

Why has it happen that the superpower ranked second or third in the list of industrial powerhouses underwent such a dramatic decline? I believe that this results from a progressive deindustrialization and demodernization which had occurred in the Russian Federation beginning with the collapse of the Soviet Union but becoming even more profound during Putin's years. Of course, the initial slump came in early 1990s when industrial production collapsed by 35–40 %, but it recovered a bit in 1997–1999, partially due to the financial crisis of 1998. But it seems to me that in 2000s the government, obsessed by growing oil prices and political «stability», deliberately decided not to restore Russia's industrial growth preferring some type of Putinomics by which I mean the process of relying on growing oil and gas incomes, redistributing them via state budget and returning a part thereof to the people and businesses via pensions, salaries, and investment. The dependence from imports became a vital part of the scheme. As a result Russia emerged as the only rapidly growing country where GDP grew faster than the industrial production (in China, the first has grown by 9,1 per cent annually from 1996 to 2007, and the latter by 13,9 per cent, in Russia – by 5,9 and 4,9 per cent). Why this happened? I have one and only answer: the ruling Russian bureaucracy is simply incapable to manage anything more sophisticated than an oil well, and has no intentions to allow the industrial sector to become more influential and vibrant than that producing raw materials and energy resources. In last 10 years the government has made nothing that would be able to contribute to the industrial growth in this country.

This point is partially reflected by Mr. Putin himself. Speaking at the World Economic Forum in Davos earlier this year, he mentioned a «redundant resource orientation of [Russian] exports and Russian economy as a whole» [<http://www.premier.gov.ru/visits/world/95/1921.html?tab=videosten> (visited on Feb. 7, 2009)] – but eight-and-a-half years earlier, in 2000 in his first address to the Federal Assembly, he stated: «The economy retains its resource orientation. Budget proceeds essentially depend upon the dynamics of oil and gas prices. We're losing our competitiveness in the global market» [<http://www.archipelag.ru/agenda/povestka/message/message-2000> (visited on June 20, 2009)]. Why nothing had changed since then and who – if not Mr. Putin – is responsible for that?

Today politicians and experts are actively talking about Russia's modernization. Has it some chances to turn into reality? My clear answer is: no. And there are numerous reasons for this.

1) In all countries that introduced modernization strategy in the past several decades there was a strong «pro-modernization consensus» in the society. More often it was build upon a widespread feeling that nation was trailing behind not only the great powers but even its regional partners. Modernization thus is the natural product of the common sense of underdevelopment. Under these circumstances both the elite and the general public united themselves in a move for «catching-up», using all the means at their disposal. In Russia today the situation looks quite opposite: on the one hand, the political elite is trying to present the current trends as getting nation up from its knees, on the other hand, a big part of the entrepreneurial class and of the ruling bureaucracy isn't interested in modernization at all, since it derive its riches from oil and gas extracting businesses as well as from other resource-producing companies. Putin's inner circle thus becomes the major obstacle to elevating the idea of modernizing the economy to the top in priorities' list. In today's Russia only a small minority of the public prefers real modernization efforts to restoring country's «energy superpower» status.

And the history teaches us that without a clear «promodernization» majority any breakthrough cannot be achieved.

2) The second problem lies in inadequate perception of economic and/or social modernization itself. These days in Russia modernization is confused with the development of high-tech knowledge economy, to which in never equaled. In all catching-up countries (and Russia definitely should embark on a catching-up path) modernization begun in mass production industries: textiles, home appliances, electronics, automaking and shipbuilding. The major part of technologies employed in these sectors were imported or stolen from more developed nations. Only after an initial industrial build-up some efforts to build a knowledge economy have been made – not at all successful in many countries. But in Russia even President Medvedev believes that modernization may be brought into life through development of aerospace projects, building nuclear power plants and designing supercomputers. This is simply impossible since for forging the technical progress of this kind a country must have a developed industrial complex to rely upon, and to produce able workforce which may be engaged in these high-tech industries. Russian experts and policymakers believe today they can «omit» the mass production stage in economic development, jumping directly into postindustrial future. They are stucked to «information society» rhetorics, not mentioning that the major economic players in America, Europe and Asia still are highly developed industrial powers with economic capabilities springing from their ability not only to develop, but also producing high-tech industrial goods.

3) The third obstacle consists of a unique Russian power system which was brought into existence under President Putin. While speaking about «vertical of power», Russian elite in fact lacks the ability to govern the economy. Nothing like Japanese Ministry for International Trade and Industry, which was responsible for modernizing that nation, is now in place. The government looks unable to provide «modernization enforcement» even inside the state-run companies like Gazprom or Rostekhnologii (the first spends three limes less on R&D than any other energy major in the world, and the second cannot develop a modern car for years). New quality standards for fuels sold on domestic market were postponed 6 (!) times due to the pressure of oil companies, the majority of which are now state-controlled (the only one private giant, LUKoil, actually has risen those standards voluntarily). Such evidence is widespread. Today in Russia the power elite is neither statist, nor liberal – it derives its influence and money from transplanting business practices inside the governmental authorities and is not able to export the command system, vital needed in the times of rapid modernization, outside the power corridors (where it fades and evaporates rapidly). In such situation all the modernization efforts will definitely fail.

4) Another major obstacle for modernization comes from a monopolistic economic structure allowing Russian primary materials and energy producers to push the price for their goods to extremely high levels. During 2000–2007 these prices increased 5–6-fold (e. g., prices for gasoline went up from \$0.23 to \$1.1 per liter, for natural gas – from \$16.6 to \$75 per thousand cubic meters, for electricity – from ¢1.46 to ¢8.5 for 1 kWh). Today these resources are in Russia 3–4 times more expensive than in China. In 2006 Russian antitrust authorities allowed two major aluminium-producing companies merge to form a giant company RusAl, and the only one condition for this was that the prices for aluminium on domestic market must not exceed those at the London Metal Exchange by more than 5 per cent. All this makes every kind of productive activity in Russia very expensive: on average, one kilometer of paved road costs three times more than in Western Europe, and building one square meter of retail sales complex – four times more. Russia badly needs new roads (it builds them at a pace of 2 per cent of what Chinese are doing every year), but in Moscow one kilometer on a new ring road is valued at €511m! The wages in Russia became too high if com-

pare them with the results produced, and at the same times the number of employees is too high (e. g., there are around 49 thousand people employed in nation's cement industry, producing 40m ton of cement in 2008; in the EU 52 thousand workers produced 279m ton). Russian monopolies are actively and effectively opposing price declines, with Gazprom, electricity companies and railways manage to rise their tariffs even at the time of crisis. The overvaluedness of all factors of production in Russia threatens the very prospects of country's modernization.

Russia of 2009 differs enormously from Japan of the 1950s, South Korea of the 1960s, Malaysia and Brazil of the 1970s and China of the 1990s. It lacks national consensus on modernization, its elite prefers the «energy superpower» status, all major «national champions» are doing their business in primary sector, and the people is happy with the rising living standards progressing alongside with the skyrocketing oil prices.

I don't see any possibility for situation to change. When the crisis erupt, Russian political elite became preoccupied not with orchestrating a profound change in economy's structure, but with preserving it from any improvement. The so called «anti-crisis programme» is focusing on helping the least effective enterprises to survive. Prime minister makes his best in providing bridge loan facilities to bailout technically bankrupt conglomerates like Deripaska's BasEl. The President organizes a Commission on modernization stuffed by the director of Rostekhnologii (unable to make good cars), fr. Minister of Defence (now responsible for everfailing GPS network), fr. Minister of Communications (under whom highly advertized «Electonnaya Rossya» project had failed and was abandoned), director of «Rosnano» venture (who had recently returned a big portion of state aid to the budget being unable to invest it into some promising innovative technologies), etc. Everyone in this country speaks today on modernization, but very few understand what it should look like.

What is to be done in such a situation? I can propose two agendas that may make modernization project work in Russia – but I should point it out from the very beginning that both seem to me quite unrealistic.

The first possibility lies in embarking on a path of a classic state-led reindustrialization of Russia's economy. Three main obstacles stand ahead on this way: high resource and labour prices on domestic market, inadequate system or financial funds allocation, and the general ungovernability of national economy. Russian government today cannot trace the money flows, control regional programs of industrial development, and even oversee major infrastructure projects (since 2000 no one big project of the kind was completed in time as well as no one was finished at a price less than 2 times greater than projected at its launch).

If this should be changed, Russia needs to recognize that today it is nothing more than a mid-industrialized country that needs industrial and technological modernization of a «catching-up» kind. The main task should be to abandon its current status of Europe's «energy attachment», and to emerge as the same attachment to China, but as a producer and exporter of industrial goods. One must recognize that Russia cannot be modernized till it exports mainly oil and gas and till more than half of its budget incomes originate from custom duties (in the U.S. this situation was in place as long ago as in 1890s). A plan designed to accomplish the transformational task may consist of three major elements.

First task is to decrease dramatically the production costs and the price of energy as well as of other natural resources. The second consists of promoting direct productive investment notwithstanding domestic or foreign. And the third task is to turn the state into an active modernizer of Russia's economy. All these tasks, I believe, may be accomplished without a dramatic overhaul of political system that had evolved in the country in recent years, but will definitely hurt vital

interests of those currently on the top. The very design of modernization I'm speaking now is a design of a clearly authoritarian modernization.

The modernization in Russia must start with a reform in resource-producing industries directed at depriving «natural monopolies» of their lobbying habits and turning them into a cash cow for financing Russia's catching-up. The resource prices must be decreased (either directly or through currency devaluation), as well as taxes on corporations engaged in their production. Nowadays in Russia the state imposes a high levy on resource producers forcing them to increase prices, and afterwards redistributes collected money into the hands of a small number of favoured industrialists. What I propose is to provide access to cheap resources to everyone who wishes to incorporate new highly productive enterprises in any branch of Russia's economy. Alongside with this a special technology importing facility must be established allowing Russian companies to buy highly productive technologies and equipment from abroad (as the Japanese have done in the 1950s with the help of the Bank of Japan and MITI). What Russia today needs is a huge inflow of new equipment from the outside world to bridge the technological gap that emerged in recent decades. In the time of crisis this may be done on very good conditions since the capital goods are now cheaper than at any time since early 1990s and the demand for them stands at historic lows.

Also the process of entering the marketplace must be eased considerably. The state must abandon the practice of forced payments for infrastructure projects now imposed on developers, the «plug-in» payments which make the electricity price several times higher than it is declared, and to ease many formalities that exist today. In 2008 an investor who wishes to build an apartment building in Moscow should spend \$1600 for its every square meter before the construction works were to start. My point is that the federal authorities must reimburse at least a half of all these expenditures to the investor immediately after the building or a production facility is completed. If forced to do so, the government would make its best to decrease these levies which today it is unaware of. From the other hand, the businessmen would declare all their costs rather than giving bribes to local officials for decreasing these expenditures. I believe that efforts like these may cut production costs in the major industries by half in 5–6 years allowing these businesses to grow rapidly. Without doing this one cannot hope for the revival of Russia's processing industries.

After this step promotion of investment activity should follow. I do not mean that we must decrease taxes here in Russia. Much more acute is today the problem of unequal competitive advantages of old production facilities over new ones. Those that were privatized in the 1990s for a penny have been long ago amortized and now became a free source of competitiveness for their owners. This complicates entering the market for new enterprises since the costs of building a new oil-processing plant stands today around \$4b, and therefore makes impossible for newcomers to compete with the present companies. This is why no one new industrial plant – in oil- or metal-processing as well as in fertilizer or chemical industry – was built in Russia since the breakup of the Soviet Union. What I propose is to abandon profit tax for newly established industrial enterprises, to half value added tax for them and to subsidize energy prices by half for the first three years of operating. I also may propose to reimburse to these companies the whole amount of value added tax which was imposed on them during the time of constructing the facility. What we in Russia need is not the overall tax relief for business but decrease of taxes on newly established enterprises and new businesses allowing them to compete with old ones on a fair basis.

Current financial crisis shows that country's banking system cannot solve the mounting economic problems and may not become a lever for modernizing Russian economy. Combined assets of all banks in the Russian Federations are less

than those of the 20th bank in the world, Spain's Banco Bilbao Vizcaya Argentaria SA. Russian banks and industrial companies cannot become a source of long-term strategic investment – because of this domestic companies have borrowed in the West for several years before the crisis erupted. Due to this one should recognize the importance of foreign direct investment into Russia's economy and provide prospective investors with even more allowances than mentioned before. In some industries where the gap between Russia and the wider world is the biggest – i.e. in producing mobile phones, personal computers and chips, in pharmaceutical industry, etc. – all the taxes must be abolished till the investment into new production facilities completely pays off. The importance of foreign direct investment should finally be recognized, and a most favourable regime for them should be established.

For a successful industrial modernization Russia also needs reform of its financial sphere – consisting among other measures in suppressing the freedom of speculative capital operations. A profit tax as high as from 75 to 80 per cent must be levied on all profits made on the stock market with investments that last less than 7 days (this tax may become smaller with the growth of investment horizon, decreasing to zero for investments of 3 years or longer). Mergers and acquisitions must be made much more complicated since Russian companies engaged in a shopping spree for each other in the last years, neglecting the foundations of organic growth. The situation of 2008 when the combined capitalization of 140 Russian companies exceeded 130 per cent of GDP, should not be repeated.

The state in Russia must turn itself into a classic developmental state. For this three kind of measures may be adopted.

First, a system of strict standards, rules and norms must be introduced in energy saving, product quality, and ecological spheres. As in the European Union, the state must enforce industrialists to decrease energy spending and to improve the quality of their produce. New quality requirements should be imposed on liquid fuels, automobile engines, energy consumption on electrical power plants, on the major part of construction materials, etc. The government must force those who cannot meet those standards, out of the marketplace.

Secondly, the whole bureaucratic system of governance must be reformed with the final aim to minimize the direct contacts between officials and entrepreneurs. The main part of tax forms should be presented via post or internet; any practice of collecting tax arrears due for three or more years must be abolished; the amount of documentation must be eased; the entrance to the marketplace should be made much easier. I propose to introduce a three-year-long moratorium on law-making in economic sphere: in Russia, e. g., the changes into the Tax Code are made every two weeks from the time of its adoption in 2005, making it next to impossible for businesses to comply with. The rules must be made more predictable and clear for modernization being possible.

Thirdly, a special governmental body responsible for enforcing modernization should be established, similar to Japanese MITI and responsible for dissemination of new domestic and foreign technologies which may be acquired in a centralized manner and forced to be adopted on all enterprises now using outdated technologies. This body may also provide companies with loans for buying new technologies and production facilities. It also should oversee all infrastructure projects conducted with the use of government funds requiring the contractors to push prices 20–30 per cent lower than they stay today in the European Union (these days new roads, bridges, and warehouses in Russia are three times more expensive than in Europe).

Under current crisis conditions some additional measures should be introduced regulating the promotion of state aid to banks and nonfinancial companies. First of all, no budget allowances should be distributed to companies with controlling shareholders registered outside the customs territory of the Russian Federa-

tion. Secondly, the aid may be distributed only to companies which are lowering the price for their goods and services on the domestic market. Thirdly, not less than a half of relief funds must be channeled into financing of sound and transparent programmes of technological improvements. I believe that today no chance for survival must be granted to anyone who had done nothing for making his business more technologically competitive in recent years. If some Russian corporations which owe huge loans to Western financial institutions may become insolvent due to these changes they must be declared bankrupt and control over them must be ceased to the creditors.

So, to summarize, the Russian state should become a developmental one and take the nation to the path covered before by the most successful newly industrialized nations. Is this possible? I'm not sure of this, because for 20 or so years the state in Russia has failed to demonstrate any sign of guarding the interests of the nation. It is now not only terribly corrupt, but rather hijacked by various interest groups for which the position in one or another bureaucratic structure is a valued business asset. Russian policymakers think and act as businessmen, and actually most of them really are businesspeople. And where power becomes business, there is no modernization in sight.

This is why I'm rather sceptical on prospects of Russian modernization. For modernize itself, Russia should make itself rid of the current political leadership which seems highly improvable. President Medvedev speaking a lot on modernization is too weak and indecisive to accomplish this task since it needs not only some decrees but a years-long rough work on breaking down the resistance of current elite.

Since, will I repeat, I have no hopes this scenario may realize in Russia, one may propose another one which is quite common for East European nations. This path doesn't require such a strong developmental state as the first one, but it needs radical political decisions to be made. I'm speaking on a pro-European policy based on accepting if not European values, but EU practices. If Russia accepts the major part of the EU-wide regulations known as *acquis communautaire*, complies with European ecological, competition, trade and some social protection standards and adopts a practice to submit to the decisions of the European Court of Justice, the modernization of this country may take another direction. I believe this option has a number of benefits because it will not only open Russia to European investments or promote more competitive climate, but introduce the rule of law in the country in which its elite behaves today as if there were no rules at all. The Turkish experience may explain what I mean speaking on Russia joining not the European Union but the «European co-prosperity zone». I strongly believe that Russia needs Europe first of all not because the latter possesses technologies and investments, but because Russia itself isn't able to use its sovereignty in a proper way needed to push economic development.

Of course, I have no illusions on the policy of Russian government. The current developments show us that Russian political elite values sovereign rights to produce laws and norms or to break them over every other asset or capability. Russia opted out of a good part of binding international treaties, it seems incapable to produce any regional integration model or to obey rules of any trading bloc. The power of current political establishment results from its immunity from any law enforcement agency, and we have no ground to believe Russia will want to participate in any grouping where it cannot dictate the rules, however valuable this participation may be. This is why the Europe-friendly rhetorics of early 2000s quickly disappeared.

So, to conclude with, I will summarize why the prospect of modernizing Russia in coming years seems to me quite unrealistic.

1) Russia today lacks both pro-modernization consensus among the general public and an elite which may benefit from modernization. It survives as a classic

rentier economy relying on vast natural resources rather than on the talents of its people and capacities of its industrial complex.

2) The very perception of modernization in the country seems absolutely outdated, based on a belief that modernization may be achieved through technical innovations rather than via profound social, economic, and legal changes.

3) An unprecedented link between business and state apparatus exists in the country making any industrial reforms unnecessary and even dangerous for highest-ranking officials surrounding Prime Minister Vladimir Putin.

4) The «vertical of power» is weak and unable to translate the decisions of those on top into practical actions.

5) Russian elite doesn't see probable modernization of its country as a process of incorporating it into the global economy; it's much more often seen as a tool to withstand the «outer world» depicted as hostile and unfriendly toward Russia.

Today many people here in Russia believe – and openly declare – that for this country there is no other option as to modernize. This, I think, is a mere rhetoric. Every country at every point of its history has a number of options. The main dilemma is whether to modernize or not to modernize. Those who choose the first path, evolve into countries like South Korea, Singapore, or Malaysia. Those who choose the latter, end up in a mess like Venezuela, Nigeria, or Angola. And I can easily imagine Russia taking this second path transforming it into a classic non-developing nation, as Peruvian economist Oswaldo de Rivero uses to label such entities. I still have some hope that Russia will avoid such a path, but only hope, and by no means confidence.