EIR Economics

Russian Economy: A Leap In the Wrong Direction

by Rachel Douglas

There was a joke in the 1950s U.S.S.R., in which the joke-teller merely recited two of General Secretary Nikita Khrushchov's thundering boasts, in sequence: "Capitalism is sinking irrevocably into historical oblivion!" "We shall catch up with and outstrip capitalism within five years!"

That classic of Soviet-era humor comes to mind, upon considering the current Russian government's drive to ram through radical reforms of what in Russia is called "the social sector": education, housing, health care, entitlements for specific social groups, and other types of "soft" infrastructure, necessary for the welfare of the population in a healthy economy. Appointed by President Vladimir Putin on the eve of his re-election last March, during May and June the new government under Prime Minister Mikhail Fradkov presented legislation to reform the social sector. In content and in scope, the intended measures are "anti-people and unpopular reforms, beyond Gaidar's wildest dreams," as one commentator put it, referring to the first post-Soviet prime minister, whose overnight decontrol of prices in 1992 slashed the standard of living and the functioning of industry in Russia.

There have been protests. The government back-tracked on some of the severest entitlement cancellations. Legislators have submitted over 1,200 amendments to the bill for the replacement of in-kind entitlements with cash payments, between its passage in the first reading, on July 3, and the second reading, scheduled for August 2. Yet, the government and the President appear committed to the basic direction of these reforms, which represent the free-trade, deregulation, anti-general welfare dogmas of Friedrich von Hayek's Mont Pelerin Society and its offshoots, in their purest form. Their implementation in Russia threatens a great national tragedy.

It makes no *good* sense for a popular President, whose power would appear to be virtually beyond challenge, to embark on such policies. It makes perfect sense for this to happen, though, if that President's team has adopted a great many of the bad axioms reigning in the West for the past 40 years: Deregulate and privatize; allow necessary infrastructure, both hard and soft, to atrophy under the banner of "free competition." These are the very policies responsible for the incredible shrinking *physical* economy of the United States, even as on-paper financial activity has ballooned. And such approaches have been promoted with fervor by Russian Presidential adviser Andrei Illarionov, especially since he arranged a four-hour audience for leading international Mont Pelerin Society activists with President Putin earlier this year (see "Mont Pelerinite Walpurgisnacht in Moscow," *EIR,* May 14).

'Ending Poverty'

Putin has declared three top-priority goals for his second term: Double Russia's GDP; reduce the poverty rate; and ensure the needs of national defense and security. The first of these goals, doubling GDP, already embodies a flawed axiom, namely the assumption that "Gross Domestic Product" and related measures, developed in the West and imported into Russia through the international financial organizations, express real economic growth. *EIR* readers may recall our one-question Economics IQ test of a few years ago, which asked, "Does $10 million (from gambling and prostitution) = $10 million (from steel production)?" For GDP, the source of monetary revenues doesn't matter.

Russian economic managers educated in the Soviet ways of measuring economic activity by physical-output indicators (flawed as they were), are not exactly comfortable with the government's new package of measures. Even the usually unflappable Prime Minister Fradkov sounded nervous and stumbled over his words, during an hour-long speech to the

Cabinet on July 8 which contained a heavy dose of the new, radical anti-general-welfare schemes. "Public-private partnership," Fradkov said, "above all means the consolidation of business and government around social projects." Now, he continued, *"the social sector should become the main generator of economic growth"* through *"pushing non-market elements out of the social sector;* new management for social projects, up to and including a managerial revolution (attracting managers from private companies into the social sector), and developing transparent and understandable rules of the game for businessmen who become active in public-private partnership."

The first step is the demolition of what remains of the old Soviet system of privileges—in-kind entitlements—received by certain categories of people. In the first draft, the government's "privileges" legislation called for across-the-board replacement of all such benefits with cash outlays. The argument for this shift was analogous to one of the ones employed by advocates of privatizing Social Security in the United States: people receive the benefits, who don't really need them, such as pensioners who get free access to public transportation, but reside in rural areas, where there is no public transportation. Shifting to cash payments, which Russia can afford at the moment due to high world oil prices, will, it is claimed, remove from the Federal budget the burden of subsidizing unneeded services. People who really need the subsidized services will be given enough cash to buy them, but for many things the payments will be the responsibility of regional governments, rather than the Federal budget.

So goes the promotional literature. In today's Russia, this proposed entitlements reform threatens to "end poverty" the way Raskolnikov in Dostoevsky's *Crime and Punishment* ended the poverty of the elderly lady pawnbroker, whom he bludgeoned to death at the outset of that novel.

An Anti-Putin Coalition?

The retirement pension received by Russian men at 60 years of age and older, and women from age 55, now stands at 1,760 rubles—or $60—each month. It is 20% below the official poverty line. Salaries for state-sector workers, such as teachers and healthcare personnel, are often no higher. But, 34 million people receive entitlements *in kind,* carried over from the Soviet system of free education, health care and other vital services. These "privileges" include free medical care and public transport for pensioners, and 50% subsidies of housing, utilities, and telephone bills for retirees and the disabled. War veterans and some others have been entitled to free travel to a health resort once a year, among other services. Counting family members, who benefit from a qualified benefit-recipient's subsidized housing and utilities, the number of Russian citizens who rely on these entitlements is estimated to be as high as half the total population of 145 million.

Cash compensation rates for these services were set, in the bill's first draft, in a range from R800 up to R2,000 (for the small number of surviving disabled World War II veterans) per month. A disabled person in the city of Moscow could spend his entire cash allotment for the month, just by taking 20 round trips on the subway!

The payments were not to be indexed to inflation, a fact that becomes more portentous in light of the next phase of social-sector reform. Under pressure from the European Union and international financial organizations, to meet standards for joining the World Trade Organization (another failed axiom being that joining the practically defunct WTO is worth anything to a country), the Russian government's agenda includes a rapid phasing-out of residential utilities subsidies, in general, especially for electricity and natural gas. Oleg Shein, a member of the Rodina (Homeland) group in the State Duma, told the *Moscow Times* in June, "If pensioners knew that in six months they would have to start paying housing and utilities costs in full, and only receive a miniscule pension raise, we would be dealing with protests by millions of people across the country."

As it was, the legislation not only took the population by surprise, but crept up on many legislators, seemingly out of nowhere. The benefits-to-cash switch was packaged under the head-spinning title, "On Amendments to Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Laws 'On Amendments and Additions to the Federal Law on General Principles of the Organization of Legislative (Representative) and Executive Agencies of State Power of Constituent Territories of the Russian Federation' and 'On General Principles of the Organization of Local Self-Government in the Russian Federation.' "

Nonetheless, on June 10 there were demonstrations against the new laws throughout Russia, ranging from 1,500 people in Moscow to larger crowds in some provincial cities. Organized by the generally ineffective Federation of Independent Unions, the rallies were small, compared with protests over wage arrears some years ago. But, wage protests have also resumed recently, in the mining areas of central Siberia and elsewhere.

President Putin's popularity rating fell sharply, to below 50%. He was elected in March with 76% of the vote. The widely-read economics weekly *Ekspert* noted that discontent was brewing even within the pro-Putin Parliamentary majority party, United Russia, only two-thirds of whose members voted for the entitlements legislation in the first reading. The participation of some regional governments in the trade unions' June 10 demonstrations, *Ekspert* observed, "may well lay the foundations for an anti-Putin coalition."

Back-tracking attempts by the government to mitigate the harshest features of the bill, have only complicated matters. One of the greatest concerns, expressed by the population and legislators alike, is that Russia's regions, rather than the Federal government, were to be responsible for delivery of the compensatory cash payments. Yet, the wealth-differentiation ratio between well-off and poor regions is, using various measures, in the range of 10:1 to 15:1. Payouts of benefits would be further complicated by patterns of corruption. In debate over the bill in the State Duma, it was noted that the Republic of Kalmykia, for example, spends only 2 rubles and 79 kopeks (less than 50¢) a month on services for each veteran living there—and that's when the benefits are being provided in kind! Yekaterina Lakhova, chairman of the State Duma Committee on Women, Families, and Youth, said that if the distribution of benefits were handed off to the regions, "Russia will become the only country in Europe, where children's stipends are not paid from the national budget."

On July 22, Fradkov nervously announced that the government would assume "full responsibility" for citizens' receiving the full volume of cash compensation they need. Health and Social Services Minister Zurabov has promised to resign, if the new bills shortchange the poor.

Physical Economic Decay

And yet, the benefits-to-cash conversion is slated by its promoters to be only the first phase of the radical deregulation of Russia's social sector. On the agenda, besides decontrol of residential energy fees, are:

- Pension privatization. José Pinera, a free market radical known as the father of Chile's privatized pension system and chairman of the Cato Institute's Project on Social Security Privatization, has been sponsored by Cato in his efforts over the past several years, to import his methods into Russia. His avowed goal is for surviving Russians to be investing "personal retirement accounts" in "real economic assets like stocks and bonds," as a Cato press release put it.
- Development of a mortgage market for financing residential housing construction. All well and good, except from the standpoint of Russia's global housing requirements. Only a small fraction of Russians (those with on-the-books monthly incomes of R25,000-30,000) would qualify for mortgages at the going interest rate of 10-15%! Meanwhile, calculations by the analyst Dr. Sergei Kaza-Murza show that the physical deterioration of the nation's housing stock is far outstripping even the most optimistic estimates of how quickly mortgage-financed housing construction could replace it. According to a study Kara-Murza published in April, 90 million square meters of residential housing (3.1% of the national total) was dilapidated or physically uninhabitable as of the end of 2001, rising by more than half again to 140 million square meters by the end of 2003. Kara-Murza calculated that the area of housing not fit for human habitation is increasing 1.5 times faster than new housing construction. There is a national program for moving people out of uninhabitable housing, which by 2010, is supposed to have rescued people from all the housing that was uninhabitable as of 2000. But, in the meantime, another 250 million square meters will have become unlivable!

The same pattern of precipitous collapse of plant, equipment and infrastructure—not replaced or properly maintained since the break-up of the Soviet Union in 1991—is visible in many sectors of the Russian economy, especially in public services, as machines finally wear out. The latest example is peat-bog and forest fires, raging around the city of Chelyabinsk in mid-July, which the area fire departments lack sufficient fire trucks to bring under control.

- "The law does not end free education or reduce the number of subsidized places in institutions of higher education, nor will it privatize them," United Russia parliamentarian Nikolai Bulayev, head of the State Duma's Committee on Education and Science, tried to reassure his colleagues on July 22. And yet, Kremlin economics adviser Igor Shuvalov recently told an audience in the Ural region that under the new approach of "putting people at the center" of the social sector (in the sense of Milton Friedman's sophistical "free to choose" slogan), there will not be free access to education in the future.
- Economist Sergei Glazyev has posted on the web site of his new movement, For a Decent Life, an analysis of the benefits-for-cash reform's impact on health care, done by Mikhail Kuzmenko, chairman of the Russian Health Care Workers' Trade Union. Based on detailed review of the May 2004 first draft of the package, Kuzmenko asserted that it "opens the door to a complete end to free medical care and transition to privatized medicine." In particular, he documented the planned elimination of subsidized higher pay and rest time for health care workers in high-risk areas, such as the care of TB and HIV patients. In a nation where, according to the United Nations Development Program's latest report, the HIV infection rate has reached 1%—the rate only a decade ago in South Africa, which today has a rate of 20%—the national security consequences of such a measure are dire.

Certainly Russia's social sector needs reform. How could it be otherwise, in a country where the life expectancy for men is less than the retirement age and the population has been shrinking by over 500,000 people per year for a decade? But to proceed with the demolition of even a poorly functioning social sector in favor of free-competition chaos, and in the absence of a national perspective to boost the real development of manufacturing and infrastructure, is to sign the national death warrant. Russia has great natural resources, which plenty of pirates are anxious to loot. Its greater resource for economic growth is the skills, knowledge, and culture of its population, who should not be subjected to an assault even more violent than what they sustained during the 1990s.