Institute of Contemporary Development

RUSSIA’S SOCIO-ECONOMIC DEVELOPMENT STRATEGY: THE IMPACT OF THE CRISIS

(brief translated version)

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CONTENTS

FOREWORD

In 2007, on the instructions of the then future Institute of Contemporary Development (INSOR), a group of SIGMA economists prepared an original work – "Coalitions for the Future" – concerning the both preconditions and conditions of realizing a modernization strategy for Russia in the 2008–2016 period. We now present a new work: "Russia's Socio-Economic Development Strategy: the Impact of the Crisis". Perhaps for the first time in the world, this is a study addressing the problem of a serious economic crisis, not from a historical point of view, but in its initial stage.

In 2007–2008, our work not only looked at the main directions of Russia's development but also presented original analysis to explain why the many development programs directed towards innovative economic growth had not been realized. The idea is about the necessity of taking into account special interest groups, their behavior, the formation of coalitions for support of realizable measures, and a system for developing compensation for the losing groups (to neutralize their resistance) appears simple at the conceptual level; however, it turns out to be extremely complex to realize in practice. In its new capacity as a multifaceted and much sought-after research center, INSOR has prepared a new study with the same main group of authors.

The global financial crisis and the crisis in the Russian economy are certainly the most topical issues of 2008–2009 discussed by politicians, economists, entrepreneurs and society. Politicians are trying to lead the country through the economic shocks while distributing resources saved by the state; economists are searching for new anti-recessionary recipes, for the first time coming up against a crisis that has gripped every country in the world; business aspires to keep its assets and to minimize losses; and the people are experiencing understandable alarm for their social status and overall wellbeing.

The Institute of Contemporary Development has been bold enough to prepare a rather unusual publication. As a rule, works devoted to a crisis are written in the genre of economic memoirs published at the end of a crisis, and in them venerable scientists professionally explain various phenomena and assess government courses, the behavior of business and social reactions.

The uniqueness of this publication lies in it having been prepared and presented for discussion at the stage of the crisis's active development, when its depth, duration, and the unequivocally "correct" contents of anti-recessionary measures could not be reliably estimated by economists and were the subject of wide discussion. At the moment of preparation of the compendium (at the very start of 2009), it was only possible to assume that we have overcome the financial crisis (or more precisely, financial panic) (at what cost is another question), and we are entering an economic crisis. The contours of a social crisis we do not yet know, and what is feared is a political crisis.

In the research presented, economists of the SIGMA group and experts from the Institute of Contemporary Development return to questions of institutional transformations in Russia, since problems retouched by income in a favorable economic situation appear with new force during an economic recession. In a growth period, proving the necessity of carrying out institutional reforms is difficult due to the very presence of that same growth. In a crisis period, everyone concentrates on "putting out fires", missing the opportunity to implement measures with long-term effects.

In this work, the new economic and political conditions for the country are analyzed, strategic alternatives for its development are considered, and solutions for some important issues topical in times of crisis are offered.

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INTRODUCTION

This work was written by us between November 2008 and January 2009. The authors risk stating reasons for the course of the global financial crisis and recession, the shocks to economic life, and the condition of society and the Russian state at the very start of the crisis. We do not yet know its depth, duration or result, and we cannot precisely predict its outcome for the Russian economy, society or political system. It is the “Book on the Winter 2008/2009 Crisis”. In it are the details of all systematic crises, since one cannot simulate them for a precise forecast of the future. It will still present many surprises to all societal forces and leading players. Important methodological approaches to studying how the shock of the crisis influences the positions and behavioral changes of interest groups, various parties of economic and public life and government policy, are all outlined in this work.

Society and business, together with the government, should seek to comprehend the degree of the threats and risks resulting from the crisis. In previous works, we demonstrated the difficulty of solving many problems, but especially the difficulty of resolving the issue of systemic modernization in Russia without involving the forces of civil society or business, the removal of hindrances and barriers to the development of innovations at the small business level, and creative individuals. All serious crises in history have been large “innovators”. Russia will come out of this crisis a substantially different country. And the crucial issue for complex modernization of the country in the 21st century will be not a technocratic problem, but a problem of social development.

The results of our research allow us to formulate the following few theses.

1. The analysis undertaken of the development of the economic crisis allows us to maintain that for the first time the world has come up against a global recession covering every country of the world, affecting both the financial and real sectors. There is every reason to assume that the world economy needs to be prepared for a rather long phase of recession (of two to three years).

In Russia, the economic crisis has come after almost ten years of economic growth, initially based on export income, then on a growing home market, and later – one to two years prior to the crisis – based on a growth phase stemming from compensating investments. However, during the whole period of growth, several problems of key value for the national economy were not resolved. Among the most important were the absence of mechanisms generating “long-term money”, the export of direct capital with simultaneous import of portfolio capital, the dependence of the economy on loans from foreign markets with the absence of corresponding sources of financing inside the country, the instability of the private property regime (among other things caused by peculiarities of privatization), and failures in competitive policy.

As a result, the Russian economy appeared to be much less sturdy against external shocks than it should have been given its favorable macroeconomic parameters, and – unexpectedly for economists – the country easily “imported” the crisis, which became superimposed onto the systemic insufficiencies of the financial system.

Anti-recessionary measures in Russia are being orchestrated to a script in a “manual control” regime. In the financial sphere, the government should make a choice about how it is to resolve such problems as the choice between a policy of “expensive” or “cheap” money in view of the necessity of stimulating the economy, controlling the threat of inflation, and preserving funds for the economy by decreasing the tax burden and providing money through the financial system, financing the budget deficit or refinancing debt. In the real sector, it is necessary to define the purposes and mechanisms to support individual sectors, branches and enterprises.

Directly concerning measures of anti-recessionary policy, it is possible to state that the crisis makes delays impermissible in the task of constructing a new model of economic development and realization of corresponding measures in the improvement of the business climate in the country, including the solution to such problems as formation of a more healthy macroeconomic environment; activation of investment demand, increase of accumulation norms, increase of innovation intensity, restoration of the role of the private sector, improvements to the banking system and many more.

2. Any phenomenon in economic life (and not only) is connected to the occurrence and/or change of benefits and costs among different interest groups. For the successful realization of this or that solution, it is necessary to provide a coalition in support of the solution consisting of “winning” groups, to level influence, and to provide compensation to groups “losing” due to the particular solution chosen. In crisis conditions, economic theory faces the problem of behavioral change among families, firms, banks and governments. The essence is in changing the micro-bases of behavior, which until now related to an undeveloped sphere of research.

Reaching a public compromise in the current circumstances is a condition for effectively carrying out anti-recessionary policy. The factor of the weight of the crisis as well as its duration will have great significance. For some interest groups, the duration of the crisis may turn out to be a critical parameter of survival. The structure of coalitions of groups for the resolution of various problems may be far from what was observed during the growth period or what could be easily defined analytically.

The complex process of forming coalitions for the sake of long-term progress is one thing, even accompanied by sabotage of opportunists and groups scared that their positions will deteriorate. The interaction of public groups anxious for their survival in conditions of an external shock and limited time for decision-making is quite another. The laws of such coalitions are different, with other methods for achieving the consent of the parties in particular.

Interests of groups influence a country's policy, which has to be taken into consideration in the likely design of the system of international institutions. From this point of view, the interactions and interests of countries are formed under the influence of history of interactions and interests of elites forced into decision-making for the amendment of middle class interests while trying to provide a certain level of social stability for the impoverished part of the population.

In the broadest view, for the analysis of the situation in the Russian economy, we highlighted 11 large "groups for analysis"[1]. These groups provide a minimal initial concept of the complexity of Russian society and its interests. At the same time, the structure of society and its interest groups only starts here: it is possible to allocate second and third tiers of subgroups for analysis, which act as operating players in their interests.

In the research, we consider the problems of groups as far as planning of institutions of regional policy (and research into groups of regions) is concerned, policies counteracting corruption (and research into problems of interaction between business groups and authority groups) and many other issues.

3. None of the strategies for the development of Russia (Inertia, Rentier, Mobilization and Modernization) mentioned in our previous works can preserve the country, its economy, territory or population. In conditions of an economic crisis, the probability of the Rentier scenario decreases substantially, and the other three retain their chances for realization. At the same time, each of them provides a path out of the crisis in its own particular way. How successful the national economy will be during the post-crisis period and how painful the losses for various groups of society depend specifically on the strategy now chosen. In conditions of crisis struggles of interest groups, the probability of the Mobilization scenario increases, but the chances of modernization of the country's development have not disappeared.

4. In order that after the end of the crisis the raw material-based model of the economy is replaced by development on the basis of innovations of Russia, the realization of a range of transformations is necessary. The most significant of these are:

- the development of a new strategy for the activity of domestic development institutions, selection of supported projects in view of new requirements for efficiency, and adequate choice of objects and mechanisms to realize projects;
- the modernization of competition policy, the transition to an active policy, and its re-orientation to change target-setting to the decision-making level in the system of government;
- making fundamental changes in the social sphere, directed towards creation of high-grade "social safety nets", reforming public health services, the pension system, labor market institutions and provision for the handicapped;
- reforming the state machinery, transition from the domination of "personnel tools" of government to the prevalence of institutional decisions, the transition from imitation of budgeting focused on the result to the real introduction of corresponding practice.

5. The development of crisis phenomena in Russia is leading to an exhaustion of the "Putin social contract" – "political freedoms in exchange for stability" observed over the last five years. It is believed that the issue of distributing the crisis costs will increase the demand for justice and solidarity as potential values for a new social contract. In the event the country manages to get out of the rut of its previous development and to work out a new formula of the social contract (for example, "a just order in exchange for taxes and civil participation"), the probability of institutional modernization in Russia can significantly increase.

[1] The intellectual elite, political class, federal authorities, big business, regional (medium-size) business, small business, high income sections of the population, middle sections of the population, poor sections of the population, rich regions and poor regions.

NEW ECONOMIC CONDITIONS OF RUSSIAN DEVELOPMENT

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Global Economic Crisis

In autumn 2008, the financial crisis in the USA turned into a colossal shock to the world financial system. This shock has accelerated the transition of recession in the USA – which had lasted the whole of 2008 after starting with the mortgage crisis there in August 2007 – into a world recession. Historians will probably date the start of the world financial crisis as that of the bankruptcy of Lehman Brothers on September 15, 2008. We are observing expansion of the first global recession with a financial crisis preceded by a reduction of real industrial production[2]. The complex combination of a fusion of the major elements of the credit system of the USA, distribution, stockbroker, a bank and credit crisis worldwide with the obvious cyclic content makes it a systemic crisis. This concept does not so much mean the scale and depth of shocks, but how far it specifies subsequent systemic changes in the economy, its cyclic model, financial sector and financial regulation, and, possibly, general rules of business functioning in the sphere of corporate control. The high speed of curtailment of production and world trade, growth of unemployment and the overall squeeze are continuing and are accompanied by a loss of trust in the economic agents of financial regulators (especially in the USA) and actions of governments, which sharply reduces the efficiency of anti-recessionary actions of state bodies worldwide.

In the previous period, the “stationary regime” of business cycles lasted a third of a century from the middle of the 1970s and was characterized by the unity of all countries within the framework of an open market economy, its globalization and wide liberalization of both the commodity and financial markets, and a transition of mankind towards attempts to resolve global problems (poverty, climate, human rights and others). Wide fluctuations in prices for fuel, huge labor migration, increased cross-border capital flows and a number of fundamental imbalances in the financial sphere were peculiar to this period.

The core of the current crisis appeared in the financial sector, having started with falling construction sector in the USA, the recession quickly traveling worldwide in the auto industry, industrial equipment and retail trade. In turn,

[2] Financial shocks – stock exchange collapses and bankruptcies – usually precede crises; but recession causes severe shocks throughout the entire financial system at the late stage of a crisis.

the crisis in capital and material-intensive branches pulled downwards both demand and prices for raw materials, especially metals and fuel. Practically identical branches are affected worldwide: construction, metallurgy, building materials, real estate and retail trade. The synchronism of the crisis throughout countries, the speed of distribution of information and the decrease in orders and deliveries are not letting up, as was earlier the case in any area which “buys instead of sells” by inertia or ignorance, and most importantly due to isolation. Reduction in demand and the spreading of the crisis is advancing in similar ways across the main regions of the world.

Economic growth was accompanied by a rise in prices for raw materials and fuel. At the same time, the weak link turned out to be neither the energy industries nor the state budgets (as during former debt crises), but private financial sectors of developed countries, which is especially surprising after the Asian crisis of 1997–1998, which promoted focusing attention on supervision and regulation and an increase in the transparency of reports of financial companies.

Apparently, at the largest American financial companies that have suffered from the crisis to the greatest degree, nobody realized up until the last moment the degrees of risk and threats for the business. Accordingly, all the country’s monetary authorities that carried out independent regulation were caught completely off-guard[3]. It is necessary to note that neither the United Nations, OECD, IMF nor World Bank monitored systemic problems and risks to the world economy, including the private financial sector.

Let us emphasize that the recession and an accumulation of budgetary problems leads to a universal delay in the solution of social and other problems, with the exception of problems representing an immediate threat to stability in countries, governments and elites. An extremely dangerous period lies ahead of us in socio-political relations (the longer the recession, the more dangerous). The previous 20 years of economic growth and its character have dramatically changed the world. Now these achievements should pass the durability test: it is possible to assume that priorities for development for governments as well as the population will be significantly reconsidered and there will be a turn towards resolving essential issues of survival in crisis conditions.

It is possible to say that a systemic failure has occurred in all bodies of supervision, analysis and control of the financial markets. The essence of the problem consists of the inability of institutions and markets to estimate adequately a set of risks. It has turned out that they can only track partial risks, but do not see systemic threats. It is already clear that together with the crisis in financial regulation it is possible to settle also a crisis in trust in financial regulators in the wide sense of the word.

[3] Regulators of the USA on the basis of the Patriot Act (“Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Acts of 2001”) substantially adjusted many world financial flows; the EU has its own system of regulation; and the rest of the world was supervised by the IMF and World Bank.

All crises are usually triggered by bankruptcies or stock exchange crashes. But in this recession for the first time we are dealing with a financial shock preceded by an industrial recession. Thus this usual financial crisis should still play its role in the process of crisis development in the real sector of the economy as a result of bankruptcies of enterprises and non-payments by firms (instead of holders of mortgages) of bank and bonded loans.

The next stage of the crisis will be long and painful if we go by history. Even with substantial growth of public funds pumped into the banking system, credits remain available only to a very limited number of the most reliable borrowers. Getting loans for risky, long-term projects will be extremely complicated. And the longer this period exists, the more difficult it will be to exit it by virtue of demand and risk restrictions and the difficulty of redistributing risks and limitation of the growing state guarantees.

Since September 2008, the financial crisis has been increasingly influencing the real sector all over the world. The credit squeeze has struck the branches most dependent on current debt financing, especially at the level of final demand (construction, trade, foreign trade operations and the motor industry). This has started probably the most dangerous mechanism of the crisis’s self-development: the transfer of a reduction in demand in industries via foreign trade. In a few months after the collapse of stock exchanges, the bubble of prices for metals and building materials in Russia and throughout the world burst. A worldwide reduction of orders and spending on capital investments began.

The inefficiency of measures to fight the banking and stock market crises, most evident in households and firms, has conditioned changes in behavior of economic agents. Instead of maximization of income in the medium or long-term (as the theory proposes), everyone began to switch at once to saving their assets by transforming them into liquid form or transferring them to more reliable banks and countries. Freezing credit is dangerous, even for a short period of time. More dangerous are the paralysis of the stock exchange and interbank credit, bankruptcies or uncertainty regarding the future for many of largest credit institutions, messages about decreases in manufacturing, and calls for revisions of almost all expansion programs of manufacturing and state accumulation. The investment process is always the main victim in a crisis (after the stock exchange).

Temporary stabilization of exchange indexes at ever lower levels does not resolve the problems: the history of exchange crises and autumn 2008's events indicate that falls will recommence, regardless of the actions of the financial authorities.

The efficiency of anti-recessionary measures adopted all over the world still remains unclear, since they come from a "traditional" anti-recessionary arsenal and are being applied against an unusual crisis. Despite assurances of support from governments of all countries, they do not specify the key point: resources lost by economic agents and families during a crisis generally exceed possibilities for aid. The "Obama Plan" – which includes a strong fiscal stimulus involving traditional (from the 1930s) programs in the field of infrastructure and in which not only the USA is pinning its hopes on – came very late, and its effect will only be felt in the second half of 2009. The duration of the recession is crucial in the sphere of coordinating actions of various countries. Even if the crisis is moderate in depth, but will last on and on, it becomes a serious threat "to a united front in the struggle against protectionism".

One more important and dangerous feature of this recession is connected with labor and social relations, which will have a direct impact on the stability of the economy, politics and governments. For a quarter of a century, the population of developed countries has not experienced such shocks, unemployment and decreases in incomes; therefore, economic difficulties are fraught with the growth of social instability. Protests and strikes (in particular by the middle class) in the years of economic expansion were directed towards elements of tax policy and social transfers; that is, towards a change in the distribution of growing incomes of companies and states. Now the social policy will be the absolute opposite: during the crisis it will be addressed to the problem of "fairness" when distributing losses. There will be competition for resources between the poor and mid-levels of the population, which differ in terms of stability and pressure opportunities, including electoral, and "street" ones. The pressure on the authorities and elites will also increase as the global crisis deepens and drags out.

The world will purportedly get out of this crisis in a couple of years (back to the pre-critical level and to steady growth) with changed laws of growth in various sectors of the economy and in countries, with different relations within power system, and with a greatly changed financial architecture. The crisis will generate growth conditions for the following period. In the meantime, it is clear that the changes will be much more serious than in the recessions of the last quarter of the 20th century.

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Recession in Russia: Sources and Reasons

By the beginning of 2009, the Russian economy had entered an industrial recession accompanied by depreciation of the ruble, growth of unemployment, and suspension of investment programs. The Russian financial system turned out to be unprepared for the world shock of 2007–2008, following the path of more developed countries – through financial crisis to industrial recession. The Russian economy is probably experiencing its first full-blown market crisis, burdened by the weakness of its financial system, which easily "imported" the shock from abroad.

Factors of growth and collapse of the Russian economy in 1998–2009

Since the second half of 2008, the Russian economy has been moving to a qualitatively different functioning mode. The key parameters of this period will be connected with the rather low prices for oil ("loss of the rent"), falling of industrial output, the growth of unemployment, and a reduction of currency reserves in the country. Although the Russian crisis was triggered by the events in the world financial markets and the recession in developed countries, the degree of this influence was connected with internal reasons and the economy's structure, a strong dependence on exports of the raw material sectors, the weakness of the private financial system, and unresolved problems in economic policy.

The growth in the Russian economy in 1999–2008 was based on the use of mainly old production capacities created in Soviet times, and defined by the stock of labor that provided conditions for high rates of economic growth with low levels of capital accumulation – of 18–19% of GDP (only in 2007–2008 did this figure rise to 21%). Relying on self-financing, low capitalization of the banking system, and a serious lag in the development of the corporate bonds market, prevented the use national savings more actively. To a great extent, both state and private savings were moved abroad, and were then borrowed through Eurobonds and loans for investments by Russian companies.

Comprehension of the necessity of modernization has not been supported by a pragmatic combination of private businesses and development institutions. In the coming years a significant amount of equipment installed in 1970s–1980s will come to the end of its working life. In view of the expected reduction in manpower in the coming years (in 2008–2011, the population of able-bodied age will decrease by 3. 5 million people), this makes it necessary to significantly increase investment into the modernization of the national economy.

The economic growth of recent years was non-uniform in terms of year, industry and territory. It is possible to highlight the following stages:

1999–2002: export-focused growth. During this period, there was a low ruble exchange rate, an improving external economic situation, and low labor costs. Low costs of transport and energy allowed Russian enterprises (principally the export-focused branches of the economy) to significantly increase output. The writing-off of enterprises' debts and their depreciation led to a clearing of artificial obstacles to growth ("non-payments" and others). A sharp rise in prices of imports as a result of devaluation of the ruble in 1998 led to a significant increase of output in industries focused on internal demand (for example, the food-processing industry). The gradual increase in prices for oil exports, from an exceptionally low level in 1998 up to the "normal" 20 dollars of the period 1986–2002 encouraged a restoration of export receipts.

2003–2005: gradual expansion of the domestic market. In 2003–2005, in addition to the significant increase in export volumes (due to growth of physical volumes as well as to a favorable price conjuncture for fuel), an important factor of economic development was growth of internal demand. The growth was not "restorative" in essence as only GDP volumes (industry has never restored the levels of the 1980s) were restored with a completely different economic structure. A significant part of economy, especially mechanical engineering and science, could not even get close to its former condition. By the end of this period, basic restrictions in the further development of the economy already started to show: above all, the underdevelopment of the financial infrastructure, a reduction in competitiveness of the manufacturing sector of the Russian economy, etc.

2006–2008: growth acceleration – "compensating" investments phase. In 2006–2008 there was a significant acceleration of investment growth rates in infrastructure and the processing sectors, which was connected with the necessity of updating existing and constructing new capacity (in many branches there was no remaining free capacity with which it was possible to engage in competitive production). But the great bulk of capital investments (up to 60% or more) went into trade, transport and communication, and housing construction – at last "compensating" the huge shortage of fixed capital in these sectors caused by low investments during the Soviet period and the crisis of the 1990s. The growth of output in mechanical engineering was also partially connected with strengthening military industrial complex enterprises.

However, investments in mechanical engineering remained minimal: a broad investment (modernization) boom had not come.

A significant part of the investments was made with external financing, which upon deteriorating credit conditions on the foreign markets observed from the end of 2007, became an additional factor of instability in investment dynamics. By the end of the period, the complexity of carrying out of the long-term infrastructural investment program had brought about a far-reaching strengthening of state companies and overdue attempts at creating development institutions and tools.

2008 onwards: recession and reorganization of economic policy. The squeezing of export receipts and internal credit began in the middle of 2008 and the recession in economically developed countries caused reductions in output. This will result in a contraction of the economy, a sharp decline of manufacturing volumes in a number of sectors of the Russian economy, and a significant decrease in investment activity.

Capital accumulation problems unresolved before the crisis

Attraction of resources for financing investments can be carried out through the banking system with the use of credit mechanisms, as well as directly with the capital markets. Joseph Stiglitz includes the following as the key functions of the financial system in his work devoted to problems of countries with transitional economies (these functions are important as part of a complex)[4]: transfer of resources (capital) from saving agents to borrowers and investors; agglomeration of capital as projects demand more capital than that of one or a group of saving agents; selection of projects; monitoring of use of funds within the framework of a project; maintenance of fulfillment of contracts (return); transfer, division and aggregation of risks; and diversification of risks. In the Russian financial system, these functions were and still are undertaken not too well, which is especially noticeable in the case of complex and large projects, which before the crisis were assisted by public funds or money from state companies.

One of the main principles of financial management is the coordination of a time structure of financial sources and their uses. This means that long-term investments in fixed capital are expedient for financing due to their long-term liabilities. At the same time, an important function of the banking (or, more generally, financial) system is the formation of "long" assets (credits) at the expense of short-term liabilities; that is, it can produce additional "long"

[4] Stiglitz, J. Financial Systems for Eastern Europe's Emerging Democracies. San Francisco: ICS Press, 1993. P. 9–10.

money not provided by long-term resources. With a relatively steady structure of short-term sources, it is possible to form "long" investments; however, risks also simultaneously increase. During short periods of favorable conjuncture one can "get by", but any toughening of external conditions threatens the system.

Since the 1998 crash, the Russian financial sector has grown significantly, but many major structural problems have not been resolved. The time terms for bank and bonded credit have remained short. The opportunity for attracting long-term bonded loans in the housing market is still limited. Pension reform has not significant funds ("long money") to the economy. The dynamics of exchange indexes with a small turnover of shares (75% or more retained by the main proprietor by virtue of having a blocking stake) is extremely dependent on small flows of foreign speculative capital. The main task – of using the country's own reserves for the purpose of development – has not been resolved[5].

A number of problems in the financial system discussed five to six years ago were still not solved during the ascent, in particular, development of the bond market for investments into infrastructural industrial projects. On the whole, time for creating institutions and tools for development, and strengthening national banks and the corporate bonds market has been wasted. Instead of the realization of a model of financial markets directed at development of the country in view of its real problems, there was a system of exporting direct private capital, accumulating state reserves (the poverty syndrome of the 1990s) and securing portfolio capital abroad – eurobonds and syndicated loans. Growth of oil prices caused ratings of Russian companies and banks to rise and thus reduced loan costs abroad. The growth of incomes conditioned self-financing investments and loans from outside the country[6]. The situation did not in any way promote either serious improvement of the investment basis of the financial sector, or creation of a toolkit for development of crucial sectors of the economy, including providing access to credit for small and medium-size businesses.

This system expanded amid escalating incomes of the country, ever increasing the scale of globalization of the national investment process. Naturally, difficulties with portfolio lending abroad in the absence of national mechanisms of reinvestment of export incomes have made the system of

[5] See: Grigoriev, L. M. Investment Process: Accrued Problems & Interests // Economic Issues. 2008. № 4. P. 54–57.

[6] Both companies and families formed portfolios from opposing segments: high profit, risky assets in the country; low profit, reliable assets outside the country; and external loans in the form increased general portfolio profitability with limited "foreigner" risk.

capital accumulation in the country rather unstable. In 2007 foreign loans only in the form of eurobonds and syndicated credits grew by 100 billion dollars, five times higher than the resources attracted from domestic capital markets.

In Russia now, a rare skew in the distribution of capital holdings among the state, business and the population has occurred. Unlike developed countries, more than half of the country's capital is held by the state. The task of increasing the accumulation ratio from 21% (2007) up to as much as 24–28% of GDP can be solved only by substantial growth of effective private investments – to a level over 32%, as is expected in the "Concept of Long-Term Development – 2020". This demands acceptance of a set of measures in the field of economic policy as opposed to simple expansion of state expenditure. In particular, it is necessary to strengthen property rights significantly and to lower both local and federal administrative barriers, and so forth.

Active promotion of capital accumulation presumes the balanced existence of two elements: accumulation assets, that is, investment projects with real economic value; and accumulation resources, that is, sources of financing these assets. For achievement of the desired result, development of both elements should be coordinated and proportional.

During the transformation processes, effective accumulation requires that two major conditions be met: the presence of protected property rights, and the provision of macroeconomic stability. But the investment process is only developed to the full after the whole system of market stimulus for capital accumulation at a micro level has been generated: the control of effective owners over diligent managers, strategic plans for increasing the value of firms after privatization, competitive conditions, credit, and stable regulations.

Firms can adapt to this or that system of stimulus, which are often named investment climates, but they are quite often linked with costs, risks and losses. Usually, in the beginning of transformation, first there is the problem of macroeconomic stabilization. Later, the problems become creation of both a favorable investment climate and a competitive environment.

A key problem of a transition period is the simultaneous formation of private property and corporate control on the one hand, and a competitive environment on the other. The Polish experience has confirmed the value of the latter, even for enterprises operating within the framework of state ownership. Stability and security of property rights are of principal importance in a mature market economy. After relative stabilization of the macroeconomic sphere in this decade, the accumulation process is still under the influence of the "peculiarities of Russian capitalism" in our country[7]. It is characterized by a high concentration of property in leading companies, private and state, which engage in global competition. The drive to privatize many Soviet, vertically-integrated companies bit by bit turned out to be a waste of time: five to seven years were spent on reintegrating them on the basis of highly concentrated Soviet assets.

The method of forming Russian capitalism was rather unique, and the result is still well off the models presumably taken as examples[8]. It is possible to formulate some of the most important features of Russian capitalism from 1990 to the start of this century, which, alongside other problems, negatively affected the internal processes of corporate control and, accordingly, savings.

Firstly, above all privatization is the specification of property rights allowing new owners to receive a guarantee of inviolability of these rights and to be assured of receiving their future incomes from new investments. But in Russia, the method of maximal despecification has been applied, and to provide precise property rights again is much more difficult. It has led to a weakness of corporate control, and formation and preservation of huge controlling stakes (75%) necessary for resale and prevention of forced mergers and unfair seizures.

Secondly, there is the prevalence of the phenomenon of the "quasi-hidden" proprietor – present on boards of directors of companies by powers of attorney from offshore. The interests of the "controller" are initially far from investments and risk, and he must retain the "seized" asset for as long as possible as he needs convincing of the legitimacy of his possession.

Thirdly, there are obvious and implicit privatization "accomplices" (instead of pension funds, for example) in the control of industrial assets, which claim a share in the income (rent). Often they participated in the privatization or personally promoted it, but could not declare legal rights and become shareholders. Such subjects continue to claim rights to income as a latent creditors or portfolio investors (among them can be officials and former officials, shadow figures and local administrations).

Fourthly, privatization has been dragged out by virtue of the initial uncertainty surrounding property rights, and its transition in the phase of redistribution of possessions. Waves of bankruptcies at the beginning of this decade were replaced by raid seizures and there was a tendency for nationalization to creep in. Here it is possible to add false bankruptcies and abuse of material and procedural law in corporate conflicts.

Fifthly, there is an insufficient prevalence of possession of assets among the country's population, which also determines the low legitimacy of property obtained during privatization[9]. As a consequence, large-scale private property, especially in the natural resources sectors, is not perceived by citizens as legitimate, which constrains the realization of significant projects. Ownership rights are not always clear, and new players become involved in various infringements at different stages of the transition period who can use administrative resources to take part in the divvying-up of old assets.

The scope and role of external credit have a large impact on economic growth. However, for Russia the time terms of credit remain short. Russia exports straight-line ("long") capital, and imports portfolio ("short") capital. Within several years, a mutually beneficial system of financing was generated: developed countries with low inflation and interest rates financed the Russian economy with higher rates of growth and inflation. Such a system allowed Western financial institutions to raise the standard of profitability for investors. In Russia it enabled the monetary authorities to accumulate record currency reserves and thus to believe that the financial sector is capable of satisfying the growing needs of the economy for credit resources. But, even after eight years of economic growth, obvious signs of serious problems in capital financing were observed: high interest rates, short time terms of bonded loans, and insufficient liquidity in the stock exchange.

Through virtually all the years of economic growth, the state was redeeming (and did redeem) all external debt, but was compelled to leave eurobonds on the market, because, among other things, pension funds would have had nowhere to place funds.

The shocks building up in the Western financial markets in 2007 revealed the inadequacy of the Russian financial system with regard to the long-term needs of the country. A reduction in the inflow of funds demands a reorganization of all models of capital accumulation in the country. The Central Bank and the Ministry of Finance granting huge volumes of liquidity reduces risks in the financial sector, but does not resolve the long-term needs of the economy as regards increasing efficiency.

[7] See: Grigoriev, L. M. Property Issues: From Perestroika to Redistribution // Russian Paths: Twenty Years of Change, 2005.

[8] See: Grigoriev, L. M. Privatization Program of the 1990s. // Comparative Stabilization Programs of the 1990s / Carnegie Fund, 2003.

[9] See: Kapelyushnikov, R. Property Without Legitimacy? // Voprosy Economiki. 2008. No. 3.

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Start of the 2008–2009 Financial Crisis

In all, Russia met the world financial crisis with large state reserves but a weak financial and credit system. In the critical phase of the crisis, the largest financial groups turned out to be completely dependent on the state, as short-term loans abroad were connected to the security of their shares, which were sharply dropping in price. The country's leaders were faced with a major institutional choice: to allow foreign holders of collateral to gain control over a huge share of Russian assets, or to pay for private business. The choice in favor of the second path gave the state very effective levers in controlling the national economy – much greater than any supporters of renationalization could have dreamed of.

In confronting the financial crisis it is not only important to adapt to the new coordinated decisions of the Group of 20 (G20), but also to modernize the domestic financial system. Unexpectedly for many, the world financial crisis has had an extremely negative influence on the Russian economy. The collapse of the share market was one of the most severe, even among developing countries. The package of anti-recessionary measures quickly adopted by the authorities is injecting into the economy huge sums of money; however, its efficiency in some instances raises questions. Moreover, the size of the anti-recessionary package and also the swift reduction in currency reserves have caused some concern in the world's financial markets, and have resulted in a weak position of both Russia and Russian shares on world platforms. We believe that such a overreaction of the Russian market reflects the fundamental problems of the national financial system – its incomplete adequacy. It is necessary to exploit the situation that has developed for modernization of the national financial system and increase its sturdiness against external shocks.

The weakness of the Russian stock exchange – its dependence on foreign speculative capital, was expressed first upon the growth of indexes up to May 2008, and then in the practically uncontrollable fall in the autumn. For a country of raw materials and energy exports, this is hardly surprising. But with the tiny free circulation of assets of leading companies and the absence of a mass of individual shareholders who would put funds into "long" assets, it was difficult to expect that investors – foreign or even domestic – could withstand such an adverse environment.

In conditions of the yearlong liquidity crisis, banks were not able to receive resources from the monetary authorities to replace the "lost" inexpensive resources from outside. Only the necessity of rescuing the payment and credit system compelled the authorities to perform large-scale injections, which, in addition to increasing the level of insurance for deposits, also prevented a mass outflow of funds from banks – runs on banks – although the silent reorganization of some unstable banks with the aid of state banks was expensive enough. By the end of 2008, credit to the population and business was reduced, expensively easing the recession.

In the fourth quarter of 2008, there was a sharp decrease in industrial and investment activity in most sectors of the economy. The deterioration of the external economic situation and the complexity of receiving extra financing led to reduced production plans and investment programs.

The greatest price shock was experienced by metallurgical and chemical manufacturing enterprises: in three months (September-November) prices fell by a factor of 1. 5 to 2. A number of countries took protectionist measures: subsidizing exports, formation of strategic commodity funds for the purchase of raw materials from domestic manufacturers, etc. In Russia, the crisis was concentrated in the same industries as in the rest of the world: metallurgy, construction materials, and the automobile and chemical industries.

The harsh financial crisis (including inflation and the fall of the ruble exchange rate) caused some additional negative effects at the early stage of the recession. It curtailed mortgages, a process that had started in 2007, and was rather noticeable even before the start of the financial shock in September 2008. More importantly, it undermined consumer credit and flight from the national currency. In particular, in Russia in autumn 2008, there was "flight" into goods: for a certain period consumers maintained their purchasing levels despite an obvious serious decrease in income. This effect continued for a short time while families tried to use depreciated savings to make purchases before the start of inflation. In future, an increase in unemployment and falling income will be more easily felt. In Russia, the effect of families' purchasing goods of long-term use, and the switching of demand to internal sources and state injections created a most rare effect: of almost zero industrial production growth in December 2008. At the same time, significant efforts to stabilize demand to prevent a further curtailment of production are required. And there is no need to exaggerate the effectiveness of measures: with the falling ruble exchange rate, a switching of demand to internal sources of goods has begun. The creation of certain programs to maintain demand in the industries touched by the recession will demonstrate the possibility of creating partially closed cycles of manufacture and demand for the stabilization of the economy.

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Scenarios and Measures of Anti-Recessionary Policy

Today one can be confident that the model of permanent and long-term growth of the Russian economy, which is reflected in a number of government documents, already does not precisely reflect reality. A slowdown of growth rates is not awaiting the country, but a significant recession, including one provoked by the world financial crisis and following the economic recession caused by the fall in demand for manufactured goods and collapse of foreign and internal investment sources of development. December 2008 became a critical month, when Russian GDP for the first time since March 1999 showed a negative growth rate. The statistics testify to how unstable the economy is, which only recently was successful, and how quickly Russia is accelerating in a reverse trend.

Three versions of probable anti-recessionary policy scenarios may be presented:

Version 1: Orchestrated: “Full manual control” scenario

Version 2: Liberal: “Natural selection” scenario

Version 3: Liberally orchestrated: “Opportunity development” scenario

Let us consider in more detail each of the aforementioned scenarios.

1. “Full manual control” scenario

The basic thesis: direct state “manual” control of economic processes will allow minimizing losses for priority enterprises and sectors of the economy.

Examples of actions:

1. Formation by the government of a limited list of significant enterprises – the largest industry enterprises on income and employees
2. Granting credit via state banks to enterprises chosen by the government
3. Foreign trade protectionist measures for protection of individual industries

Expected result: as a whole, the pre-crisis inefficient structure of the economy is kept, positive changes in competitiveness are not observed, there is a redistribution of assets in favor of structures close to the state, negative social consequences are limited, but the exit out of the crisis is delayed.

2. “Natural selection” scenario

The basic thesis: market forces, without external intervention, will naturally select the most effective economic agents and fastest restoration of the economy.

Examples of actions:

- Removal of administrative restrictions for development of small and medium-size business
- Decreases in taxation

Expected result: “natural selection” of the most viable companies leads to a general increase in efficiency of the economy; thus, mass bankruptcies of enterprises, including ones cities are based around, leads to sharp negative social consequences and some industries in Russia ceasing to exist.

3. “Opportunity development” scenario

The basic thesis: a system of actions and measures directed at minimization of the consequences of crisis, including state support of investment demand in key industries and final consumption, and creation of a stimulus system for formation of the economy with set characteristics (competitiveness, diversification, innovation).

Examples of actions:

- State credits for investment purposes in key industries
- Tax privileges in realizing projects to increase efficiency
- Maintenance of employment through state infrastructure (including road) programs and municipal construction
- State purchases in key industries (including, possibly, formation of state reserves of certain types of goods)

Expected result: preservation of levels of production and employment throughout the crisis, and an exit from the crisis with a more competitive economy due to modernization of the industrial base in key industries and infrastructure.

The set of measures realized by the government of Russia is mainly characteristic of the first version. In fact, the crisis has automatically forced the authorities into action and “mobilizing” the economy. To protect the economy, the authorities are using more and more widely the resources saved in the reserve fund, national welfare fund, and gold and exchange currency reserves of the Bank of Russia. The majority of anti-recessionary measures have an "individual" character, i. e., are allocated to specific companies according to special decisions of the authorities. In some cases the use of money allocated by the authorities to banks in ways other than was planned ensures tight control over the fate of this money down the whole chain. In addition, the fight against the crisis is accompanied by an increase in the share of state ownership. In some cases this is the natural result of state support of companies, and in other cases the granting of aid is used as a lever to gain control over attractive assets.

In the sphere of monetary and credit policy, the most symbolic and largest action of monetary authorities was the phased devaluation of the national currency, which came to an end on January 23, 2009 with the establishment of a corridor of rate formation in relation to a bi-currency basket with a range of 26–41 rubles per US dollar. Assessing the Central Bank's rate formation tactics as positive on the whole, it is necessary to state, however, that the monetary authorities have arrived at several "crossroads" in their actions.

First crossroads. The current exchange rate policy of the Bank of Russia, nearing a mode of the so-called floating rate, permits solving the most acute problems: allowing the population time to comfortably decide what to do with their savings, and to refine (on the basis of transition to targeting) instrumental monetary and credit policy. It is also essential for the intermediate term (two to three years) to reduce considerably the pressure of monetary inflation (to reduce it to a level of six to seven percent). It is difficult to keep financial balance without a consecutive decrease in the rise of prices.

As Russia differs from many other countries with its high inflation, it has another vector of monetary and credit policy. Keeping interest rates high and aimed at the refinancing rate nevertheless demands guarantees in 2009 of at least zero real profitability for deposits (better, of course, minimally positive). This task in itself is not easy. The complexity of its solution increases in conditions of serious risk of establishment of superfluous control over the money supply, when excessive restriction of the monetary base and restraint of growth of the monetary mass could finally lead to demand for money not being completely satisfied. As a result of such demonetarization, the phase of exit from the crisis could be considerably delayed. The monetary authorities thus should define what "price" they are ready to pay to cap inflation, which, if it gets out of control, is capable of canceling out all intermediate positive results of exchange rate policy.

The second crossroads before which the regulators stand is connected with the transition inevitable in 2009 to a new model of money supply. Reduction of capital inflow to build up international reserves, and the limited opportunities of use of the latter for purposes not connected with maintaining budgetary stability mean that the main source of formation of the money supply should be an increase from the Central Bank of total credit to the banking system. Efficiency of further steps of the monetary authorities on increasing liquidity will depend, first of all, on the condition of the banks, an increase in their stability, and the ability of regulators to consolidate the banking sector.

In conditions of radical strengthening of the role of the banking system in the formation of money supply, regulators stand before the necessity of overcoming a third crossroads: to keep the status quo, relying on the natural succession of events in the course of the crisis, and cleaning up the weakest participants or reforming the banking sector as a major condition for creating a competitive national financial system.

In addition, the transfer of the center of gravity to actions of regulators to liquidate the deficit of long money will demand an answer to the question about how far it is possible to combine the granting of long-term liquidity through the financial system and leaving similar resources in the economy by means of decreasing the tax burden. The speed and contents of such an answer are fundamental: business should receive a clear signal (right down to a schedule of actions of the monetary authorities) to delimit their own maneuvers.

Budgetary restrictions in 2009 and subsequently in 2010–2011 will predetermine the necessity to go through a fourth crossroads: to either direct resources generally towards the financing of the budget deficit, or to refinance external corporate debt (no less than $130 billion in 2009). It is obvious that in actual political practice, a decision directed towards achievement of both goals will be chosen.

However, regardless of any decision, there must be a promotion of private business in the role of a main motivating power in overcoming the recession. The readiness of the state to move actively in this general direction however has until now not been obvious to the participants of the market. Meanwhile, it is a central question of trust, the strengthening of which would be promoted by precise reference points of dismantling in a post-crisis financial system with a superfluous share of state assets. Accentuated measures to strengthen competition and protection of private property are extremely important. Most of all, they are necessary for the formation of the business climate, and stimulating efforts of private business to adapt to the crisis.

In times of crisis, the instinct of the manager and business executive rises against the absurdity of spiraling reductions in demand and manufacturing. The first anti-recessionary reactions usually lay in the logic of prevention and restoration, compensating anything and everything – a fast return to normality. But the crisis quickly shows up rigid and reduced budgetary limitations.

The main problem of the anti-recessionary policy is not in the intentions of the government and not in the sincerity of the victims requesting help, but in the distinction between the interests of economic agents in conditions of growth and crisis. In the autumn and winter of 2008–2009, the real sector and government representatives worldwide (including in the USA and Russia) expressed bewilderment and irritation at banks concerning the public funds received and then spent by them on their own needs, and purchases of other banks. Similarly, funds given to families could support demand or go towards the purchase of currency – what promoting demand for domestic industrial production does not do. Also with companies: the granting of funds (in any form) should be conditioned by the clear purpose of an anti-crisis regulator: geological prospecting in the oil-and-gas industry; credits for car buyers in the auto-industry; and completion or expansion of construction of inexpensive homes and roads for construction firms. In any case, in the long-term getting out of the crisis will be down to corporate control, de-monopolization, institutions of competition, and a decrease in barriers and corruption. In many cases (if not in the majority), economic agents have more complex motivation than officials believe; they possess a greater mastery of methods and tools (and also insidiousness) than officials; they have a much bigger spread of interests to preserve capital and their way of life than just maintaining capital investments, especially risky ones, than officials think they do.

The applied measures of support in leading branches and enterprises are diverse. With a reduction in demand and threat of spiraling development of the crisis, a question of principle comes into play for state policy: who exactly, and for what purposes, is it more preferable to support? Losses to economic agents during a recession are so great that any adjusting or compensating influences are obviously weaker. Adjusting influences of the government at an early stage can be directed towards rescue from bankruptcy of certain key economic agents; formation of macroeconomic conditions for reorientation of actions of economic agents; reduction of panic and prevention of panicked actions independently capable of destroying economic life.

Certainly, there is no such thing as “abstract support” – within this term are hidden a compendium of measures for social welfare, priorities of state policy, bank injections, charges for various types of business (large or small), attempts to “pay” for stability against the threat of mass bankruptcies, or to find a point of interrelation with other branches and to limit their spread. The government is compelled to solve an important problem: whether it wishes to support end consumer or investment demand, people, or firms. In the

first case, the emphasis is on pensioners, grants, and keeping workers in manufacturing. To some extent it is inevitable, but it basically solves the problems of sociopolitical stability. Still, it is necessary to understand the limitation of this approach: it cannot pull industry out from recession and preserves an ineffectively developed economy. In addition, a limitation of resources will in any case not allow support for all victims (in a poor country) so they lessen the pressure.

The general rule is to support those segments of end demand that can recover the demand of domestic manufacturing along the demand chain. Also, it is necessary to recover gradually various banking segments for the revival of demand for long-use goods. Finally, all economic agents, including families and businesses, should get a good chance at adaptation. Removal of barriers hindering business and restriction of rent pressure on business are absolutely necessary to retain employment and a new chance of growth. Some decrease in consumption is inevitable, but its uniformity and the exclusion of social failures in the regions or industries are important. Social justice in crisis conditions is rather difficult to realize. The exit from the crisis should provide chances for the enterprising, rather than the victim.

The government of the country is realizing a set of measures characteristic mainly of the first version, which can lead to additional consequences:

- Significant growth of the share of state assets
- Distortion of market motivations
- Irrational use of limited resources due to realization of mutually exclusive industry measures or measures limiting positive effects (for example, expansion of infrastructure projects in combination with an increase in import tariffs and duties)
- Elimination of internal more effective competitors by selected enterprises.

An important lesson that should be learned from the crisis is that poor conditions for business (unpunished seizures of property, absence of independent courts, corruption) are not compensated by a favorable macroeconomic environment (for example, cheap money), or an advantageous external economic situation. One of government programs several years ago that suggested stimulating development by a forced decrease in taxes, which can be done quickly, to improve investment conditions reasonably quickly is impossible. But experience shows that this path shows little promise anyway: without perfection of the investment climate it is only possible to have a short spurt, with steady development remaining impossible. So, the abundance of money provokes financial bubbles, a decrease in taxes leads to budgetary risks, and a rise in the price of oil allows no room for improvement of the business climate, moreover, it is a passing phenomenon. In addition, serious improvements to state institutions are an obligatory precondition of exiting the raw materials development model. Without a solution to this problem, the economy is doomed to a recurrence of crises, no matter how much is accumulated in currency and budget reserves.

On the topic of anti-recessionary policy measures, it is possible to state that the crisis will not permit delays in the task of building a new model of economic development. Its basic difference from the former model should be that its orientation is not an extensive, but an intensive factor of growth. Some necessary items for this change include:

- Formation of a healthier macroeconomic environment. For this purpose it is necessary to provide attractive interest rates, a transition to a more flexible exchange rate policy, a sequential decrease in inflation, and the prevention of the formation of bubbles in the financial markets.
- Activation of investment demand and increasing the norm for accumulation. This problem needs to be solved despite the much more complex macroeconomic conditions than before: in the first years, with a background of limited availability of bank credit and foreign capital, and then even after the end of the crisis, with attractive interest rates. Hence, the main role should belong to improvement of the investment climate.
- Increasing the intensity of innovation. At the present level of development, most important is not masses of essentially new know-how being formed, but development of the best technological and administrative processes for today, i. e., the borrowing of high technologies created around the world. For the achievement of this aim, the creation of a competitive environment and preservation of the openness of the economy are of key value.
- As an important measure of support for the economy in the crisis, a decision to reduce profit tax was taken, and other measures to simplify the tax burden have not been ruled out. At the same time, the task of increasing investment in human capital remains. This demands regular work to increase the efficiency of budgetary policy and find solutions to problems of state policy in conditions of limited budgetary resources.
- Restoration of the role of the private sector, which inevitably should decrease throughout the fight against the crisis. Already the state is increasing its share of the economy, obtaining shares on the stock exchange and taking control of banks that have got into difficulties financially. It is necessary to take vigorous measures for the prevention of abrupt nationalization of the economy after the end of the crisis.

- Improvement of the banking system. It is necessary to achieve an increase in its capitalization and absorption of relatively weak banks unable to exist amid the deterioration of the external economic situation. Important tasks are increasing financial transparency of the banking system and perfection of the system of risk assessment by regulators and the management of the banks.
- Transition to more subtle economic policy tools. An example is the necessity to use mineral extraction tax rates for oil – differentiated in view of actual conditions of development and extraction.

Solutions to the problems listed are only possible within the framework of all-round modernization of the economy, including reform of the administrative system, creation of an effective and independent judicial system, and formation of trust in government policy, state and market institutions. The cornerstone should be a change in the mutual relations in the “authority-society-business” triangle. Significant progress in modernization of public institutions is possible only in the event that we manage to create a basis for partner relations between the participants in the triangle. A necessary condition here is societal recognition of developed property rights, and their active protection against redistribution at all levels, greater social responsibility of business, and effective control of society over authority.

GROUPS INTERESTS AND RUSSIAN DEVELOPMENT STRATEGY

Leonid GRIGORIEV

Groups Interests and Problems during the Global Crisis

Before the global crisis, the political behavior of countries was basically adjusted within the limits of political logic with rather "soft budgetary restrictions" for the EU, and significant growth of debts in the USA. Economic problems were significantly influenced by the political logic of the leading players, as seen in the politicization of problems of energy security. The global crisis sharply limits financial restrictions for the freedom of political decisions, and accordingly the cost of political aims and intentions of rational economic decisions sharply increases. The general threat – world recession – should change the character of interaction between political and economic problems.

The losses inflicted by the first world market recession in history (which is gripping both Russia and China) are already huge for many countries and sectors of the economy. But ahead lies sharp growth of budgetary deficits, the occurrence of new important priorities for society and governments, and loss of urgency on some prickly issues of the beginning of the 21st century. There is no need to understand in theory that cooperation in joint actions in restricting the acuteness, scale, duration and consequences of the global recession is absolutely necessary. But will the political problems that have developed limit the efficiency of world cooperation? The end of the crisis in 2010–2011 will not mean a return to the beginning of this century. There will be regular global changes in industry and services, and countries will win or lose in varying proportions during the crisis, but also especially afterwards in the long-term.

The aim of this work is to consider some important questions of international (mainly economic) relations in the context of crisis as an external shock to the developed system of relations. And simultaneously we shall try to outline approaches to coordination of internal interests of influential actors and foreign policy. Questions of decision-making on critical issues or circumstances concern national or international (and regional associations') interests, rules and laws. We believe that in the traditional analysis of international problems there is often no analysis of the institutional maps of a situation, whose interests and positions inside the country reflect the economic (and external) policy of the country[10].

[10] We believe that the method developed for discussion of coalitions for the definition of strategies inside the country can also be applied to the definition of interests of influential groups in foreign policy in countries and in important international questions. See Grigoriev L. M., Conflicts of Interest & Coalitions / "Pro et Contra", September 2007; Coalitions for the Future. Russian Development Strategies/ SIGMA Group of Economists, RIO-Center – Moscow, 2007.

Positions of countries and countries' elites

We believe that elites of countries, especially countries with deep interests and positions on a number of problems that formed historically, naturally define the key elements of policy of their countries. Certainly, the democratic process changes elements of authority (government), but in developed democracies, the distinction of values, principles and policies of competing wings (internal coalitions) of elites is usually not so contentious.

That means we distinguish the interests of a country and position of the elite in authority, which may or may not coincide, especially in case of a long dictatorship or usurpation of authority. Simultaneously, we distinguish declared and revealed values of elites and interests of countries in a purely pragmatic way, which correspond in essence to the clashing elements in the positions of elites.

At the same time, complaints of the elites about the management of their countries and outside influence are based on a combination of values and a message to their own and other people. Elites value position in society, protect it and build relations with the middle class and poorer layers rationally (that is, we exclude dictatorship as a rational internal public agreement).

Democratic countries are justifiably proud of the high degree of unity of values of the elite, and high degree of their acceptance by other layers in society. In view of the great role of the media, unification of processes, and similarity of historical genesis, economically advanced countries with a market economy and developed democratic system also possess a high degree of coordination of the elite. At the same time, national interests and distinctions remain, and elites (for example, in France) maintain their features and try to avoid dissolution, despite the processes of unification of the legal field, information space, and way of life.

With regard to the elites of countries with democratic systems currently taking shape, with just a medium level of development, and traditions not yet established, it is much more complex. For example, the replacement of elites during the transformation from the Soviet system – it moving over to markets and democracy – was not able to progress easily and imperceptibly by the rest of the world. In a number of cases we are observing conflicts among new elites; for example, the gas conflict between Ukraine and Russia to a large extent is determined not only by objective distribution (commercial) conflicts, but also profound conflicts among important segments of the political and intellectual elites of the two countries.

The position of elites in the diverse world can (and should) thus be seen from several planes: relations with other social forces within countries against a backdrop of rivalry within the elites; relations with elites with similar values, though with differences and rivalry persisting; correlation of elites' stated values and limited capability to act globally according to strict principles and ideological preferences – forced external pragmatism (usually existing amid higher internal severity); and, finally, rivalry among elites with varying histories and values.

Similar elites, despite their differences, in effect have (or try to have) an international contract (agreement) on basic values and principles of behavior that is as durable as possible. In relations between elites, we also see a historically determined respect and tolerability, apart from in cases where one of the elites (like a fascist one) begins to openly seek the destruction of other elites as part of some messianic program. Moderation and respect between political elites is linked with rivalry and agreements between financial elites, coexistence, and mutual entry of intellectual elites into each other's ranks. This is a difficult harmony, one that was achieved after centuries of conflicts and two world wars in the 20th century. It is based on the recognition of the need to avoid large-scale conflicts between elites, and on the recognition that they have inherent differences and legitimate interests in their countries and worldwide.

The "End of History", which did not occur, was in part a form of expression of the victory of the values of Western civilization in the rather radical form of militant liberalism. New global problems and frictions show the unreality of a program of quick victories of the values of one – even a very significant and powerful – group of elites over all the others, let alone in the form of fast reeducation and even replacement of the persevering elites (including not only political, but also ideological components). The global economic crisis greatly weighs down the agendas of elites (and their governments), and increases risks to the stability of domestic ones and the demands for success in the anti-crisis struggle. Once again we see a struggle not for a share of the growing pie according to agreed-upon rules, but for a redistribution of losses from the crisis. The threat of more intense conflict between elites due to various historically unresolved problems or new ones, especially economic ones, increases. The wisdom of elites consists of supporting a certain balance in the domestic contract with other strata and in the system of external agreements intended to reduce not only direct losses due to conflicts, but also excess "insurance premiums" against possible conflicts (whether political or economic) in the future.

Success in solving the material problems of countries, the stability of the middle class and gradual improvement in the living standards of the poor are important indicators of the success of elites, which is confirmed periodically in the electoral process. Disruptions to social stability, external shocks or threats, are not only a problem for a country or group of countries, but also a challenge for the elites – a test of their ability to diagnose domestic and external problems and achieve development-related objectives. The domestic contract of elites with other strata of society is, of course, complicated by national, social or regional disproportions or an unfavorable dynamic in their development.

Rivalry among political forces in developed democracies occurs even while the main actors continue to rely not only on principal values and the existing legal system; exceptions on the fringes of the political spectrum have been rare in Europe. But one's attitude towards peace and the existence thereof are also important. The undisputed superiority of democracy over autocracy in the long term, combined with technological and financial superiority, gave the wealthiest nations (often referred to in Russia as the "Golden Billion") the unique possibility of positively influencing the world's development for a long period of time[11]. The end of the Cold War and the arms race provided an ideal chance for the world's development. But it was not a mandate for the "liquidation of history" or the establishment of the rule that "this elite is always right", but rather a mandate to safeguard the histories and cultures of other countries as well as their political histories in order to accelerate development.

On the whole, the focus of discussion among the leading powers of the world in early 2009 was a certain "global economic governance" – a new order. It is necessary to decide upon joint anti-crisis measures, which are essentially rules for redistributing the losses due to the world recession. The world financial architecture after the collapse of 2008 is the key to growth in the post-crisis period. Putting energy-sector relations in order is essential to stable world development and climate preservation. The Millennium development goals and the fight against poverty also must not be lost as the drama of the recession unfolds.

Global problems: their reflection in interests

The political picture of recent years has become rather tense: there is no sign of the serenity that was supposed to follow the "funeral of history" à la Fukuyama. The world is becoming more and more interdependent; events on one continent no longer appear, or are perceived, as isolated from distant continents. Migration now is calculated in millions, and money transfers from guest workers amount to tens of billions of dollars a year. The wars in Iraq and Afghanistan continue, the Palestinian problem is once again being decided

[11] The latest research does not show a direct link between democracy and GDP per capita; but a link can be seen between the indicators of democracy and a positive growth dynamic in well-being.

by force, and the Iranian problem remains on the agenda. Add to these the conflict of August 2008 in the Caucasus region, Somali pirates acting with impunity (in the 21st century!), conflicts in Africa (Congo, Zimbabwe), the growth of populism in Latin America and instability in Pakistan. Of course, the governments of developed countries are trying to positively resolve world problems, but in a way that does not adversely affect the interests of their elites, middle classes and poor citizens.

In practically all conflict situations and unresolved problems, there is no longer a single coalition of states of the Warsaw Bloc standing against NATO and the democratic countries. By the turn of the 21st century we began to see a significant difference in the interests of countries (and elites) in every complex world problem. By no means did all of the NATO countries participate in the operations in Iraq, and the United States and Europe are not of one mind with regard to Iran. And there are differences both in specific state interests and in elites' views. One can see differing views among elites on the issue of climate change – between the administration of the United States in the last eight years and European governments, though there is a consensus on the level of the educated middle classes. Russia has its configuration of state interests, and its elites (though not yet fully formed) are trying to find their place among the world's elites.

Russia just recently emerged from its transition crisis and is trying to find a place for itself in the club of great powers, which assumes the existence not only of a strong economy and army, but a stable and responsible elite (not a simple matter considering that the change of the elites occurred over a period of two decades) and a sufficiently mature middle class. Russia's new political elite laid claim to a "traditional" place and role for Russia in the world, stressing its multi-century history, while downplaying both the particular shadow of the Soviet regime and the recent transformational crisis. The signal appears to be rather simple: we have no ideological agenda, so let us forget about 1917–1990 as well as 1990–1999, retaining from these periods only elements of general human interest. Russian interests are substantial in themselves for the country's development and the elite does not see a reason to abandon them on the basis that the USSR laid ideological claims to too much, geopolitically speaking. It is difficult to find any substantial social group in Russia that would offer a radically different concept of national foreign policy interests; domestic problems, of course, are debated in the same way that methods of achieving foreign policy goals are.

The overall situation in the world is unstable and forces one to think about an acceptable way of pacifying the world. Actually, everyone needs to pause in order to resolve the problems of the dangerous economic crisis, as well as

minimally acceptable terms in order to allow Barack Obama, Nicolas Sarkozy, Dmitry Medvedev and others to work out new terms and rules of cooperation to solve problems related to stability and world development.

Until recently, almost everyone in the world economy had it good; but now we are seeing wide swings in oil prices – from $8 to $145 and back down to $50 per barrel – a weakening of the core of the world banking system, a crisis on the stock exchanges, and several countries on the verge of default. In short, a far cry from stability. The start of the world recession in the autumn of 2008 is helping us test the maturity of world governments and their ability to pull the world economy out of the economic crisis without it entering into a political one.

But whom do we trust: the consciousness of governments or elites? And who are we?: no doubt the middle class, or more likely even the so-called "mid-middle" educated class. Can we, at a difficult moment in history, believe in the readiness of the world's leading elites to place limits on themselves, work out compromises, get the general consent for reduction of tension and restoration of working financial markets, and prevent commercial and social conflicts? Most likely, we have no way out. Having accepted these elites once, it is very difficult to break loose from their embrace; it is simply impossible economically, and very costly politically. This was attempted in the early 20th century, not by the middle class, but by the proletariat, and only as a last resort. But the world is changing and communication is increasing thanks to the information revolution. So it is possible to at least formulate one's own vision of the world based on a certain consistent logic. A natural criterion would be an approach according to the criterion of stability, conditions for development and a minimal tendency toward conflict, along with a certain self-limitation on the part of leading actors in order to solve the world's problems.

The possibilities of coordination in solving long-term, costly international problems largely depend on rationality, unity of objectives (values and interests) and the common sense of the main influential actors within countries. The main forces and problems affecting the process of working out goals and means can be roughly listed: the traditional political elite, apparent problems of big business, the middle class and its search for stability, the religious views of influential groups of society, special regional interests or the interests of the poor masses, and notions of the broad educated strata of society (the intellectual elite and middle class) resulting from a certain history of how the country was formed and informed.

Elites usually have excellent opportunities and resources for pushing through their agenda as the country's agenda. The importance of intra-country limits in the sphere of international coordination suddenly obtained serious confirmation last year when many NATO members declined to recognize the independence of Kosovo for a number of their own reasons. But we believe that consistent analysis makes it possible to separate the country's serious economic problems from the ideological and historical needs of the elites in the formation of foreign policy. This is important also because the world is becoming more and more compact and observable, though not more manageable.

The crisis is leading to losses for practically all players – governments, companies and families in countries throughout the world. In autumn 2008, the agenda changed. The world transitioned from a discussion of how to rationally use the growing resources of the leading countries to solve global problems, to a discussion of the crisis and how to distribute short-term and long-term costs and losses. In the European Union, a broad coalition on protecting the climate and the need to radically reduce greenhouse gases emissions was formed. At the same time, national energy strategies differ significantly. But methods of achieving threshold values by 2020 remain a subject of serious dispute both on the national and European levels as they are associated with a number of political issues like energy dependence, attitudes towards nuclear energy, regional cooperation, etc.

Elites have historically played the leading role in this process, but the middle class is the group that votes, that determines the importance of problems, that is the point of reference and whose ultimate interests must be considered when developing the very idea of the whole country's interests. We would suggest that national history and the traditions of elites play an enormous role, though in the 21st century the democratic process presupposes that interplay between the actions and beliefs of elites, the middle class, national and religious factors, the level of development and the poverty factor play an enormous role. Democratic elections show more clearly the positions of interest groups and parties, but in these aspects politicians base their reasoning on existing notions of the country's external threats and goals, trying to win over allies from the appropriate influential electoral groups (in terms of numbers of members, financial capabilities, access to media, etc.) with their traditional notions[12]. At difficult moments in history – crises and times of conflict – the elite finds itself responsible for fast and effective decision-making in support of economic stability. After a quarter of a century of relative prosperity, the middle classes are counting on preserving their financial stability and way of life while the poor strata of developed countries are not prepared for an abrupt worsening in their material situation. Developing countries (dozens of them) may find themselves once again set back in their development. Also under threat is the entire global agenda; during a difficult crisis it is often not possible to solve problems that involve significant expenditures at the start and delayed positive effects.

A key question for the world will be the character of the new policy of the United States in the post-neoconservative era. How the American elites will view their responsibility to the country and the rest of the world is playing an increasingly important role in establishing world economic and political governance. In our view, the essence of such a contract in the American case is rather simple: the elite took upon itself the role of world guardian (judge) by providing the middle class with an observer's – almost a juror's – place, while the poor, for their part, serve in the army and defend democracy. Though this approach is oversimplified – life in the real world is far more complicated – in it lies an opportunity to refocus attention on foreign policy and world problems. The responsibility being accepted by the country's elite for world affairs also presupposes the expanded involvement of civil organizations in developing democracy – the globalization of the middle class and its long-term interests in stability and democracy.

For any other country (including Russia), the link between foreign and domestic policy is a problem of correctly assessing the presence of real or expected foreign threats for the country (or for the elite). For a superpower, no simple threats can possibly persist at the moment, as this would cause the elite to collapse. As it turns out, it is possible to set out the idea of the "absolute" security of one country from all substantial threats: terrorism, military rivalry and energy dependence. This goal perfectly harmonizes with the idea of saving the world and spreading democracy. The logic of the American political elite's behavior is to try to offer its middle class and population as a whole the leading role, both with regard to the spread of democracy and the values of Western civilization, practically in conjunction with ensuring security from any threats outside its world and control. Recent events have shown the complexity and extremely high price of such a policy and the impossibility of consistently achieving long-lasting results.

[12] There are a number of examples of parties or elite groups creating external conflicts (usually with ideological neighbors, and on emotional issues) in order to win domestic elections. This can be regarded in theory as a type of opportunistic behavior in which the long-term interests of the society at large can be sacrificed to the interests of a narrow group.

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Accounting for Group Interests in Anti-recessionary Policy

All phenomena in economic life (and life in general) are linked with emerging and/or changing advantages and costs for various interest groups. In order to successfully achieve the stated objectives of this or that decision, it is necessary to provide a coalition in support of it consisting of "winning" groups, while neutralizing the effect on the "losing" groups from the decision that is adopted and providing them with compensation. Accordingly, it is only possible to assess whether or not decisions (including strategic and economic ones) are sensible by taking into account an analysis of what is gained, what is lost, negotiating power and possible compensation to the support groups and confrontation groups. This thesis has not only been theoretically illustrated in numerous publications from the SIGMA[13] group of economists, but has also been successfully approbated in research that is more applied in nature. This work belongs to the given research concept and is a continuation of a publication devoted to the formation of coalitions to modernize the Russian economy[14].

In crisis conditions, economic theory comes up against the problem of changing the behavior of families, companies (small and large), banks and governments. The crux of the matter lies in changing the micro-foundations of behavior, which until recently was an undeveloped sphere of research. Textbooks on "crisis management" do not contain chapters on "typical behavior" in a crisis because such research is very complex and decision-makers in critical situations tend to vary their behavior.

Changing group behavior in the crisis: formulating the problem

The task of balancing forces and compromises when the economy is growing may be in the simplest form reduced to the most effective distribution of resources possible after removing resistance (distribution-related conflicts) with blocking groups. In a crisis, the positions of the main players change, since fluctuations in profitability in the crisis are non-trivial and independent in nature. They cannot be easily reduced to a simple reduction in income or lowering of absolute positions achieved during the upswing. On the contrary, in a crisis, factors influencing the overall situation change in favor of holders of consolidated resources (reserves of regulation from above or horizontally) in favor of industries and regions to a lesser degree associated with the crisis sectors, as well as in favor of the weakest interest groups, but that are able for whatever reason to block the work of the other actors. In state policy it is necessary by historical measures to instantaneously move from the redistribution of a growing volume of resources to another system of redistribution – the redistribution of losses. Strictly speaking, when compensation is rising, additional resources go to the holders of some sort of blocking factors. During a crisis of compensation, this means a reduction of (these same or other) losses of elements of the economy and society.

The science of economics has not worked out any sort of special theory of behavior of economic agents, households and companies in the crisis. Investment functions and other key variables are usually simply considered as dependent on external influences. In this work we will consider the main changes in the situation and the reactions of public groups (and subgroups) to the crisis shocks; therefore, it is necessary to draw attention to the following questions.

The first problem is identifying threats and risks for groups of society, business and the state. In shock situations there is a rather high threat of a panic reaction, with a very brief horizon for planning while economic agents ignore their own losses and costs. Panicked behavior (capital flight, runs on banks) may have a firm foundation in historical memory. Preventing panic is apparently an independent task that to a large extent depends on trust shown towards public leaders and elites.

Second, all elements of society become more active in the crisis. Standing idle becomes difficult. Protecting revenue channels or cutting costs while income is falling requires action. The problem lies to a large extent in the differences between the actions that can be taken by participants to preserve or improve their positions. The adaptation process will occur more or less rapidly depending on (1) how democratic the society is, (2) how clearly business people think, and (3) the qualifications of the leadership. Of course, the high level of activity exhibited by all actors greatly complicates coordination and presupposes risk-taking, and the probability of opportunistic behavior increases. Therefore, the orientation of many companies in relation to support from the state may turn out to be ineffective by virtue of the increased activity of all those who seek assistance.

[13] See: Grigoriev, L. "Conflicts of Interest and Coalitions" // Pro et Contra. 2007. № 4–5; "Coalitions for the Future: Strategies for Russia's Development", the SIGMA Group of Economists, Moscow, The Russian Industrialist, 2007.

[14] Grigoriev, L. M., Plaksin, S. M., Salikhov, M. R. "The Post-Crisis Structure of the Economy and Forming Coalitions for Innovations", Economic Questions, 2008, No. 4; INSOR board chairman I. Yu. Yurgens (chief editor), "Strategies for Russia's Socioeconomic Development: the Effect of the Crisis, part 1, Moscow, Econ-Inform, 2009.

The third problem is determining a consensus on the time horizon to be allotted for negotiating ways of overcoming the crisis and the sequence in which problems are to be solved. Reducing the planning horizon changes the actions of a number of behavior patterns, particularly among business groups and the general population. In all probability, threshold problems will emerge during the crisis. The speed with which they are solved can affect the actions of other groups both by virtue of objective chains (income, availability of goods, infrastructure support) and by virtue of the demonstration effect and the creation (or loss) of trust. Awareness of the realistic horizon of the crisis also affects attitudes towards state support. Whereas in the narrowest horizon, financial injections may seem capable of saving the recipients, in the long-term they cannot replace the recipients' own efforts to survive and improve their positions.

Fourth, the problem of protecting one's own interests (surviving) is not identical for the various groups of agents. Everyone sees threats to their own "substantial variables", which they try to protect. The stability of such parameters is the opposite of bankruptcy – this term is used hereinafter in the generalized sense as failure and disruption of the continuation of the normal existence of this or that agent or group in society or the state, and not in the direct sense of commercial bankruptcy in business. For example, the inability of a governor to prevent extremely unequal losses among companies and achieve understanding of the situation with public forces, the absence of a system of stabilizers (civil society in particular), or conflicts between participants in the public life of a region may be seen as the bankruptcy of management. This characteristic does not depend on whether a solution to these problems (redistribution of losses) and consent among the conflicting groups to a "fair" solution objectively existed, or the governor was in an unprotected position; some bankruptcies occur for objective external reasons and cannot be prevented. Similarly, maintaining control over property will be of critical interest since losing control is the bankruptcy of the owner's strategy regardless of how well the company is doing.

Fifth, we consider it necessary to note the fragmentation of interests and coalitions. During periods of growth, the breadth of coalitions strengthens their negotiating strength. During economic upswings, the political elite can ignore some interests of business people, regions, social groups, or elements of the intellectual elite. However, in a crisis, creating and supporting coalitions is made more difficult precisely because of differences between the vital interests (substantial variables) protecting the actors. It is possible to expect narrower, more energetic and shorter-lived coalitions according to a narrow set of critical problems (loans to banks, the ruble exchange rate, new customs barriers). For example, during the yearlong liquidity crisis in the United States, our banks were unable to force through a decision on access to domestic savings held by the state. As the crisis unfolded, the shock, awareness of threats and severe pressure quickly bore fruit, though the result was rather controversial. During the crisis there will be new victims who were unable to maintain their positions, not only in business but also in all large groups.

Sixth, protecting one's most substantial interests when one is aware of threats of bankruptcy prepares one to compromise for the sake of preventing bankruptcy. Particularly uncooperative groups (blocking coalitions) trying to improve their positions in the crisis may hinder the adoption of acceptable decisions. Forcing people to cooperate in such cases is an extraordinarily complex idea to formulate and is dangerous without adequate representation of interest groups in the state. On the whole, the idea of universal concessions proportional to the threat would be useful in more quickly achieving a new balance (on a higher level), though this least of all presupposes fairness in the market economy. Profits and real income are falling for people of varied roles in the economy and at different levels of the socioeconomic ladder.

Achieving societal compromise today is a precondition for an effective anti-crisis policy. The severity and duration of the crisis will have enormous significance. For some groups, it is precisely the duration of the crisis that may turn out to be the critical parameter of survival and consent to changes in one's behavior.

The composition of the coalitions of groups or, more likely, subgroups, to solve certain problems may be quite different from what was observed during the upswing, or from what could have been easy to analytically determine. The crisis may become a time for identifying new problems, a new societal agenda, and the bankruptcy of certain ideas or groups. But changes in relations among forces in society and the economy, by virtue of the growing activeness of certain elements, will also demand that forces with new agendas step up their efforts.

One concern is the complex process of building coalitions for the sake of long-term progress, even as opportunists and groups that fear a worsening of their position sabotage such efforts. But another concern is interaction between societal groups that are concerned about their survival when external shocks occur and there is limited time to make decisions. The patterns of such coalitions are different, presupposing, among other things, different ways of achieving consent among groups, more persistence in defending positions, and a significant threat of irrational behavior. Accordingly, it is more probable that conflicting coalitions will be created, and that an arbitrator will be sought along with a center of trust or a system that could ensure a balance of interests.

From large (analytical) groups to an analysis of subgroups

In the most general form (in the works mentioned previously) we singled out 11 large “analytical” groups: the intellectual elite, the political class, the federal government, big business, regional (mid-sized) business, small business, high-earners, the middle class, and the poor, as well as rich and poor regions. These groups provide a minimal initial idea about the complexity of Russian society and interests. But the structure of society and interest groups only begins here – it is possible to single out a second rank of analytical subgroups of people acting in their own interests. We will note several principle aspects concerning interest groups.

First of all, dynamism in the interests of the players, groups, and thus, coalitions in time is critically important. For every major issue of the country’s reform or economic policy, the composition of coalitions is constantly changing. They will begin to change during the crisis as well, and, as we noted earlier, much faster.

Second, social strata (as they are represented in the groups) cannot directly join coalitions and need either representation (for example, in the form of parties), or other direct or indirect ways of protecting the interests of key participants.

In effect, groups are not homogeneous and fragment or collapse into subgroups along lines of more private “secondary” interests. However, these interests may be fundamental from the point of view of these subgroups themselves, surpassing in importance more general “primary” interests relevant to the entire large group. Subgroups may have economic power and specific interests (and negotiating strength) perhaps comparable to the corresponding characteristics of the general group (for example, the oil and gas sector of big business).

The most obvious example of a secondary interest group spinning off from a larger group is an “analytical” group, spun off from “developed regions”. Of course, advanced regions (usually donors) have common interests with regard to the size of and rules governing the redistribution of their consolidated budget, but the interests of regions that export raw materials, old industrial regions and prosperous capitals differ considerably.

It appears that private secondary interests, along the lines of which division into subgroups occurs and which turn out to be more important than the common interests of the analytical groups as a whole, in fact spin off on the basis of distribution-related conflicts over specific resources.

Third, the position of an analytical group on a specific issue is formed not in a top-down fashion, but rather from the bottom up, that is, the positions of the subgroups determine the position of the analytical group as a whole. In other words, its unified position is formed either according to the lowest common denominator (for example, the legitimacy of property), or as a result of the action of a system of coalitions and compensations in the relations between the subgroups of the analytical group. Apparently, common interests are formed in response to external pressure and serious problems. In a crisis, subgroups are most likely to disagree based on the need to champion their own interests, both within and between large groups.

Fourth, in Russian conditions, with the country’s colossal variety of interests, forming secondary coalitions is urgently needed. The government’s very acts of passing laws and making decisions (even the wrong ones) means finding some sort of compromise; i. e., the leading players win while someone else loses and receives compensation if he manages to demonstrate his ability to put the brakes on the implementation of the decision and the possible negative consequences of similar actions.

Fifth, in Russia’s conditions, all “analytical” groups are “non-degenerate” and are divided into several subgroups by content. The second level of these groups is essential for generalized analysis, but, naturally, is not the last one. Taking into account the country’s diversity, one or two additional steps are needed in order to single out more or less homogeneous interest groups.

Sixth, from the methodological point of view, when analyzing interests of groups and possible coalitions it is necessary to take into account the specifics of those groups that can substantially influence negotiations on key problems of economic policy. They must be characterized by significant negotiating strength, regardless of how many members they have (which again becomes important in the election process). This makes it possible to involve in the analysis more specific characteristics of groups (secondary and tertiary) both in terms of the state and in business and society.

In order to analyze the relative positions of groups with regard to specific important policy issues, this is most likely about the matrix of subgroups’ interests (“44 x 44”). Accordingly, in one or two steps it is possible to come across quite specific, more or less (taking into account the country’s geography) homogeneous groups, the accounting of whose interests in social and economic policy may be considered as a given and a sort of constant, at least for short periods of time.

Interest groups as a condition for the implementation of anti-crisis policy

In the crisis, not only do the targeted functions of interest groups acquire new significance, but so do the goals of creating coalitions and building compensation systems. For example, in a favorable economic situation, an optimal (from the point of view of societal efficiency) system of coalitions and compensations must be directed towards coordinating the behavior of interest groups as a way of limiting the maximization of the groups' short-term interests. By limiting the selfish behavior of groups in the short term, all groups may win in the long term through a net increase in wellbeing rather than as a result of its redistribution between groups.

In a crisis situation, first, the planning horizon is reduced to the short term; second, it is out of the question that all interest groups (participants in a broad coalition) can win. It may be supposed that, in a downturn, an effective aim of coalitions for society will consist in ensuring more equal distribution of losses.

Furthermore, the objective standing of interest groups changes. For example, earlier, during the upswing, metals, trade and transport clearly became part of the backbone of the economy alongside oil and gas. But as the economy declines, at least the first two of the above-mentioned leading second-tier groups are experiencing serious problems and are among the largest groups lobbying for help from the government.

In the crisis, one can also practically declare the loss of the single-industry focus among large companies as they diversify into other industries. As a result, classical inter-industry conflicts (for example, between exporters and importers) are brought to companies, i. e., an internalized market form. In such a situation, predicting a growth strategy, dominant interests and the behavior of such a company in the crisis becomes a non-trivial task, which may be the object of separate research.

The target functions of interest groups directed towards preserving existing resources and fighting for redistributable resources cannot but create several objective conflicts between groups. It is possible to single out several main types of conflicts:

1) Conflicts between donor groups, from which resources are taken for redistribution, and receiving groups, to which resources are redistributed;

2) Conflicts between various groups of recipients in the competitive struggle for the resources being redistributed (first and foremost by the federal government);

3) Conflicts between Moscow, as the central element of the system of resource redistribution, and other groups, including conflicts associated with including some groups in the state support system while ignoring the needs of other groups.

Any redistribution of resources during the crisis faces the risk of unscrupulous behavior by those carrying out the redistribution. Since the target function of these individuals also consists in preserving the current level of wellbeing, they will strive to preserve in absolute terms the volume of resources being sent to groups close to them. However, as total receipts fall, the share of resources being sent to affiliated groups increases, which means that unaffiliated groups account for most of the reduction in the total amount of resources. In other words, the resource distribution system may not ensure equal (or more precisely, proportional) distribution of losses in the crisis.

The relations of the main interest groups to the crisis and the severity of distribution conflicts to a large extent depend on the economic policy steps that are taken, which can be illustrated using the examples of how anti-crisis policy affects the distribution of property and the country's exchange rate policy.

The threat, noted long ago, of excessive borrowing abroad by private companies and state-run companies began being implemented when stock exchanges were falling and margin calls were being made. A significant proportion of borrowing was for property purchases rather than investment projects. To a certain degree, companies were forced to borrow from the West, as domestic savings were unavailable and interest rates were high. Naturally, as was expected, state funds are being used to support state-run companies. Big private companies with foreign debts found themselves hostage to the state both literally and figuratively. For this reason it is necessary to emphasize the importance of the previously-mentioned problem of defining the time horizon of anti-crisis measures taken. In light of the usual low efficiency of state corporate management, increasing the state's share of property in the economy requires the development of a mechanism for the future use of this property. Whether it be a second attempt at mass privatization or financing the pension system, it is necessary to think through the consequences and mechanisms now. But in this case, the principle considered earlier comes into play – the one that says that protecting the most substantial interests when one is aware of the threat of bankruptcy makes one ready to compromise for the sake of preventing bankruptcy.

In the short term, devaluing the national currency would find support from export-oriented companies competing with importers in the country. Furthermore, devaluation of the ruble must reduce the burden on borrowers, who have seen interest rates on loans in the Russian currency consistently increase throughout the entire crisis period.

On the other hand, there would be obvious losses such as those of companies with foreign currency debts, companies that depend on imported accessories, and the middle class and poor with savings in the national currency.

A simple listing of the groups supporting and fighting this measure clearly shows that even on such a simple matter there must be an additional division into subgroups in the big business and medium-sized business analytical groups. Furthermore, we will note once again the possibility that conflict situations will emerge within big business, when some business units win from devaluation while others are encumbered with serious debts in foreign currency.

It should be noted that the other groups and subgroups outside the business category also receive certain advantages or bear certain losses from devaluation. For example, the federal government will find it easier to fulfill the social obligations it has taken upon itself, and budget revenues in the regions where exporting companies are concentrated will increase. From the long-term point of view, devaluation is obviously a necessary step in ensuring that the country’s industry is competitive, though its positive effect will be less noticeable than in 1998 due to the absence of unused capacity

Using currency devaluation as a tool must first and foremost take into account the above-considered problem of agreement about the character of development in the near future. A series of “micro-devaluations” begun suddenly gives economic agents a chance neither to prepare for the devaluation nor determine its duration or severity, which introduces an additional factor of uncertainty in economic behavior and postpones many decisions.

An opportunity to modernize the economy after the crisis

The set of measures being laid out for the short-term outlook in foreign trade, credit and investment policy is being done so under the influence of business and various lobbyist groups’ objective conditions, while at the same time the global economic crisis is directly tied to resource redistribution. Individual players at the end of the crisis will be looking for places to invest their vast amounts of accumulated resources. To secure an influx of investment into Russia, including from Russian investors’ foreign bank accounts, immediate, systematic work is needed to enhance the country’s investment climate (judicial reform, fighting corruption and much more), no matter the short-term efforts of lobbyist groups. Experience shows, however, that the federal government has not always been successful in this mission. Many short-term measures have had a direct negative impact on the effectiveness of measures for developing already-existing sectors of the economy in the

long-term, especially since many businesses during the economic crisis will attempt to put off long overdue institutional reforms and business restructuring and shuffle risks onto the government’s shoulders.

The state in its current form has shown that it is not capable of implementing short-term and long-term measures simultaneously. Regulations and incentives have not been introduced, the tools for development were brought in too late, and the ones to fight the economic crisis ended up not being relevant to the task at hand. We now have made a coerced switch to a micro-management style, which at meetings serves to shake up interests not just through its bureaucratic instinct, but also through the complete and utter absence of any of the necessary tools.

A contingent state action based on realism and strict budget limitations is absolutely necessary for the country’s economy to break free from the chains of the economic crisis toward innovative growth. A system for making state administrative decisions should be based on giving businesses and families the greatest number of opportunities to adapt as possible. Decisions should be made as quickly as possible with the opportunity to delegate some of these decisions to the lower branches of power that currently lack any initiative.

What makes things difficult is that the main interest groups are currently focused exclusively on short-term measures and are unable to put any pressure on the government to progress long-term measures. In other words, the authorities are forced to search out measures by working not only to put out the flames of the current situation and with defunct feedback mechanisms, but also without any clear signals from interests groups as to their advantages in long-term measures. Ending the economic crisis will require an enormous effort to making sweeping coalitions and compromises that include rudiments of society, the intellectual, business and political elite that evoke faith and trust. Simultaneously, there is no doubting that key groups will try to maintain their coalition agreements, as possible new, post-crisis coalitions could to a large extent be distinguished by partnership criteria among the main groups. It is also important to know which groups' interests, especially potential blocking ones, should be taken into account.

Moreover, the modernization scenario calls for all groups, especially the elite, to keep their interests under self-restraint. In an economic crisis this calls for using relevant rules for redistributing losses among various groups. A tough recession lies ahead and lop-sided losses have been incurred by all or the majority of players in Russia’s social-economic and political life. As the economic crisis bottoms out, the grounds and coalitions will come together for revamping development for the future.

Corruption: Structure and Specificity

Extensive research has demonstrated that corruption has a negative impact on economic growth, savings and development aid efficiency, while creating income inequality and poverty[15]. Yet the channels and levels of its impact are as broad-ranging as are the spheres in the society in which it grows. The academic definition of corruption sees it as a normal form of economic behavior that is picked from the bag of alternatives, both legal and illegal. This is precisely why forming non-governmental, public organizations is so important – these organizations determine the advantages and disadvantages associated with competitive behavior models. Corruption occurs repeatedly under specific conditions and in a specific institutional environment. In becoming a part of economic and social institutions, corruption molds together its relevant interests to influence existing institutions, their initiatives, and the speed at which they change.

Classifying corruption

Corruption is a non-uniform phenomenon that affects various aspects of society's political, economic and social life and has its own unique mechanisms for originating and re-occurring. Consequently, there is no one silver bullet for fighting corruption, rather the ways for doing so have to be determined depending on how and where they are applied.

To have a clear view of the impact of corruption on economic growth and of the measures needed to counter it, it is expedient to look at the corruption spread in today's institutions and how this corruption changes the institutional structure. Table 1 shows the types of corruption and each type's characteristics.

[15] Gupta, Davoodi, and Alonso-Terme 1998; Hall and Jones 1999; Anwar Shah 2004; World Bank 2004.

Table 1. Corruption typology

Type	Subject		Origin and Spread	Voluntary Corruption Exchange	Degree of Concentration	Uncertainty Level
	Bribe Taker	Briber				
Lower Administration 1	Civil servant, rank-and-file bureaucrat*	Citizens	Private institutions market	Voluntary and involuntary exchange	Less centralized	High
Lower Administration 2	Rank-and-file bureaucrat*	Businessmen				
Upper Administration	Local and federal bureaucrats in policy-making positions*	Businessmen and local and regional bureaucrats		Involuntary exchange (business capture)		
Corruption with "state capture" (upper-echelon corruption)	Elements of the political elite	Businessmen, regional and federal bureaucrats in policy-making positions	Political institutions market	Voluntary exchange	More centralized	Low

* Permitting the possibility of certain corrupt earnings being transferred up or down the administrative ladder is a must. The former is a sign of the authorities' loyalty, while the latter represents a corrupt transaction and keeping quiet.

** The possibility for selling positions ('nourishing') cements a corrupt system.

Influence of different types of corruption on economic growth

In evaluating the impact the different types of corruption have on economic growth, one finds that there is a significant redistribution taking place – between social groups in favor of consumption at the expense of state and business funds. Administrative decisions and state policy as a whole become less efficient. Corruption in business assumes a shift upwards in a project's profitability in order to pay off hidden "rent"[16]. Here corruption effectively causes a disregard for less profitable and longer-term projects in favor of shorter-term projects with a quick revenue return. Corruption's overall impact is felt in lower savings rates, which are unlikely to be compatible with goals for increasing economic growth rates and modernizing the country. Table 2 presents the relation between corruption types, the subject of corrupt transactions and the economic effect they have.

[16] There are examples of critical state projects not being implemented since their participants fear sanctions should there be embezzlement or unauthorized use of funds. Participants, however, ca not do their work without corrupt fund redistribution, since there are numerous links in the lower administrations that expect their share.

Table 2. Subject and effects of a corrupt transaction

Types of Corruption	Reason	Corruption Effect
Lower Administration 1	Service; accelerating a legal decision, bypassing sanctions for violating the law	Redistributing personal wages, forcing out low-paid individuals from utilized state services, lower quality of service and creating social conflicts
Lower Administration 2	Administrative barriers	Redistributing profit into personal income (deducted from investments), increasing the level of certainty. Reproducing errors of the first and second kind, cutting regulation quality and creating demand for "state capture"
Higher Administration	Distributing state expenditures and bureaucrats seizing personal assets	Transferring budget funds to businesses, distorting the structure of government spending in favor of high-cost projects to the detriment of improving the current infrastructure's support, cutting the efficiency of the state's current and investment spending, and lower reform quality in the state sector
Corruption with state capture (upper-echelon corruption)	Redistributed benefits	Redistributing authority, expenditure powers, shifting administrative goals in favor of a narrow group's interests, creating favorable terms for the growth of administrative corruption (decadence in the quality of property and contract rights and an increase of administrative barriers)

A rise in corruption decreases the capacity of state decisions to allocate resources, thus redistributing them in favor of less efficient, though more aggressively-corrupt companies, and potentially less efficient industries and regions. A change in the terms that set group interests during the economic crisis will change what their incentives and opportunities are, which will be associated with the state pressuring business (a relative increase in the corruption burden), business pressuring bureaucrats (increasing the level of corruption, theft, and attempts to seize state assets) and an escalation in the fight for state resources (see Table 3).

The drawn out economic crisis and reinforcement of budget limitations could lead to changes in the state's investment policy, like curtailing the number of investment projects in order to maintain the most critical infrastructure blocks. This, in turn, would run afoul of the interest groups losing their corruption revenue, meaning that any changes would be stonewalled. Here, state economic and investment – with a high degree of upper administrative – corruption can be described as sluggish with few opportunities to adapt to various external shocks. There is little choice here – two options are presented besides sudden recovery: (1) players in the economy have their payments cut in favor of corrupt links, while the state, business and public have their opportunities limited. This is the corruption system's survival strategy that keeps its rent coming in; and (2) protecting corruption revenue regardless of the surrounding environment's deterioration, thus increasing corruption for business and the public. Attempts at cutting one group member's income in favor of that of the others are possible depending on the reallocation of resource groups' negotiating strength within the state machine. This could, however, create instability within the system, as similar attempts previously led to scores of people being exposed for their actions and the coinciding government structures having their authority undermined. There is no illusion that another reaction of corruption to the economic crisis significantly increases the risk of confidence in measures being taken being undermined. Major conflicts in an economic crisis can be politically dangerous at a time when the social-economic situation is becoming increasingly unstable.

Table 3. The economic crisis's impact on the spread of corruption

Types of Corruption	The Economic Crisis's Impact on the Spread of Corruption
Lower Administration 1	A possible drop in demand for services leading to a fall in the average bribe amount. Understandable social conflicts founded on attempts by clans in various groups to leech off peoples' "squeezable" income
Lower Administration 2	Maintaining the current corruption burden on business with a decrease in revenue leading to exit from the business sphere or taking a portion of it abroad and/or to the black market, with a possible fall in the average bribe amount accompanied by an increase in the frequency of corrupt dealings
Higher Administration	Influential interest groups striving to secure their revenue claims serve as sources of corruption in the state investment sphere that will limit any opportunities for state investment policy to adapt to external shocks; A fall in demand in the private sector presenting enhanced competition for state contracts, which is thus connected with an increase in the average bribe amount; Private parties increasing pressure on civil servants for corruption purposes, which include theft and putting a stranglehold on state assets; A spread in cases of personal assets being seized by the government or through the government possible under the guise of measures to deal with the economic crisis.
Corruption with state capture (upper-echelon corruption)	The economic crisis broadens the possibilities of preferential treatment and aid being given to different market investors. This could become a cause of business increasing pressure on state agencies to redistribute preferences, which could result in an intensifying economic concentration (the economic crisis squeezes out those lacking a stranglehold on the market). The fight for various spheres of influence flaring up within the state apparatus is a possibility

Measures to counter corruption

Political will and the political elites' willingness to act in a system-based manner (and not just through demonstrative economic stimulus processes) are critically important parts of the fight against corruption, which need to start with uncovering problems and introducing legislative instruments. The level of support for anti-corruption measures being put forward by the state from various social groups, the very same ones that can directly or indirectly affect these measures' effectiveness, is an entirely separate issue. This is precisely why the level of social confidence in state institutions and the amount of compensation[17] given to groups losing out while these anti-corruption programs are being carried out is so important.

Table 4. Measures for countering corruption

<table>
<tr><th colspan="2">Types of Corruption</th><th colspan="2">Countering measures</th></tr>
<tr><td>Lower Administration 1</td><td>Voluntary</td><td colspan="2">Heightening opportunity costs for civil servants;
Increasing the expected gravity of punishment.</td></tr>
<tr><td></td><td>Involuntary</td><td colspan="2">Generating quality standards for state services;
Developing means for protecting consumer services;
Creating an information and consultation service for protecting consumer rights.</td></tr>
<tr><td>Lower Administration 2</td><td>Voluntary</td><td rowspan="2">Decreasing the scope of regulations, changing their specifications and removing them as a whole;
Reducing discretionary areas in legislation;
Increasing opportunity costs for civil servants;
Increasing the expected gravity of punishment.</td><td>Creating regulations for carrying out and monitoring state functions</td></tr>
<tr><td></td><td>Involuntary</td><td>Increasing competition between parties carrying out government services; developing extrajudicial means for solving conflicts;
Increasing personnel responsibility.</td></tr>
<tr><td>Higher Administration</td><td>Involuntary</td><td colspan="2">Removing the state from the infrastructure policy sphere, where market crashes are non-existent;
Set sights on recruiting private investment for creating infrastructure (for example, franchising);
Developing institutions for regulating the placement of state or municipal orders for work regarding state needs;
Developing institutions for regulating state or municipal aid;
Developing institutions for regulating the allocation of rights to state resources;
Designing effective mechanisms for coordinating operations of government agencies that control budget expenditures.</td></tr>
<tr><td></td><td>Involuntary (stranglehold on business</td><td colspan="2">Refining the judicial system and developing institutions for protecting property rights;
Partitioning the authorities and business</td></tr>
<tr><td>Corruption with a stranglehold on the state (upper-echelon corruption)</td><td>Voluntary</td><td colspan="2">Stiffening competition between interest groups in big business.
Developing business associations that implement general interests, not private ones;
Forming effective antitrust institutions;
Creating potent public mechanisms for producing new rules that take business' and the expert communities' opinions into account;
Increasing the degree of laws and mechanisms for controlling financing by political parties' private organizations.</td></tr>
</table>

[17] Here only actions or inaction (not entire groups) that determine the possibility for implementing foreseen measures for fighting corruption are highlighted for purposes relating to compensatory deals. Moreover, compensation can come in different forms: a change in status or financial standing, introducing set-aside changes that are associated with the relevant group's decline, etc.

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Regional Policy: Crisis Challenges

The economic crisis's impact on different types of regions

The economic crisis's development is based to a large extent on changes in behavior of economic players that react to a drop in economic indicators and a threat to their own stability with the same actions that lead to their spread. An abrupt reduction in the planning horizon, a shift in development efforts toward survival ones, and attempts to decrease bankruptcy threats to very important parts of the economy are all being felt among families, enterprises and regions. Since the economic crisis hits neither all at once or evenly, redistributing losses now becomes the task at hand. This entails an effort to guarantee the function of critical networks in production and primary product consumption, and propping up employment and social services. Any risky and long-term projects, innovations and capital investment are inevitably afflicted.

Regions face the problem of having enterprises with unpredictable behavior that cut their production, including employment, salaries and taxes, because of falling demand often outside the regional market. Investment programs are partially annulled, while local industries and small and medium businesses are hurt by the local squeeze on demand. Budget investment resources that are often co-financed by the federal budget are immediately squeezed. An uncertain prognosis for the country's economic growth, an expected cut in federal program financing and a continuing fall in regional budget revenues (varying forecasts see 30 regions having trouble financing their current spending for 2009; many industrial regions' budget revenues in January 2009 fell by 30–50%) are forcing regional management to deal with several tough problems: transforming growth strategy and securing personal stability and efficiency amid growing calls for help from below and limited calls for help from the above[18].

The industrial line-up in the recession began to take shape at the beginning of 2009. This includes everything from banks, retail trade and housing construction to metallurgy, construction, construction materials and further down the spiral. The geography of the crisis is also becoming clearer,

[18] During the financial crisis the objective cost of management mistakes for the economy and social-political stability and subjective liability (and promptness of punishment) are rising for the people of the regions, and also federal authorities attempting (based on previous experience) to support themselves, and find the parties responsible for unpopular decisions and the sequence of events.

with it first and foremost hitting export/resources-oriented regions and large cities since they are tightly knit with the global economy. The former rode the tide of rising world demand and commodity and redistributed product prices, while large cities first got hit by the economic crisis through of banking, construction and retail trade problems. Risks for more modernized territories with developed industries are much more prevalent, although a common vector here puts special emphasis on geography.

Risks taken during the economic crisis can be evaluated taking into account a region's main economy, budget risks (depending on the most significant taxes paid by businesses, which for regions is primarily the profit tax), and employment sectors highly susceptible to a recession (industry, construction and paid services), and in single-industry towns, small business' role as a possible victim (demand for its products and services fall) and potential for absorbing workers made redundant.

One can split the most problematic regions with different combinations of risks into several groups. Regions with only one export are the most worst off of all; especially those working in metallurgy have been hit hard: global prices have fallen by a third and both world and domestic demand has dropped dramatically. Moreover, metallurgy, a prevailing sector in single-industry towns, is very labor-intensive and its employment numbers have barely been cut in the post-Soviet era. Therefore, the budget risks are as big as they can get. Several metallurgical regions depend on one or two large corporations for sustainability, with 35–40% of their budget revenues coming from profit tax. These regions had been rather well off in recent years since this tax goes mainly to the regional budget, and metallurgical companies, as opposed to oil and gas companies, are more often registered in the regions and not in Moscow. The oil and gas business in the regions is in somewhat better standing since primary revenues are realized in the regional capitals. The rate at which industry is collapsing in these regions is already at its pinnacle and the economic crisis as a whole promises to be as severe as ever.

This type of scenario is less likely for specialized oil-and-gas regions, be it as it may that their state employees are highly dependent on large companies. There are at least three reasons here that mitigate the situation: (1) employment restructuring in oil companies was already conducted at the beginning of 21st century when auxiliary subdivisions were forced to learn how to survive independently and were allocated for outsourcing; Gazprom was not the only company to have done this; (2) significant rotational employment, the first to be cut, slowed the local population's unemployment; and (3) other workers, mainly former migrants having arrived in Siberia from all over the country, are better at adapting and are more mobile compared with workers at metallurgical enterprises in single-industry towns in the Urals who have been working there for generations. Most of all, the federal authorities first and foremost will lend a helping hand to oil-and-gas-producing regions, since the country lives off of their resources.

There are significant though varying risks for industrially developed regions with more diversified economies. In the Sverdlovsk Region, which was a leader in economic growth along with Tartarstan in the beginning of this decade, the millstone around its neck will once again be numerous single-industry towns with out-of-date metallurgy enterprises belonging to large companies. The car manufacturer AvtoVaz, suffering from growing foreign competition and still incapable of radically improving its product quality, poses a critical problem for the Samara Region. These risks are added to by a recession in the service economy and construction in cities with more than a million inhabitants. Experience from previous crises, however, shows that a multifunctional economy in a metropolis is more capable of adapting, especially if the institutional environment does not choke business, including small business, which is better developed in these regions.

This assertion is even truer for the country's two largest metropolises, though they will be forced to pay for some errors on their part. Moscow was the biggest benefactor of the economic boom in having become the profit center for all natural monopolies and the majority of large commodities companies. The city thus accounted for 26% of all taxes collected while having only 7% of the country's entire population. Profit tax from companies made up 66% of the city's budget in 2007, which was much greater than in specialized export regions. The city's budget grew like wildfire (by 200 billion rubles annually), making any thoughts of expenditure efficiency superfluous. A wake-up call would do the city some good. The Moscow Region's economic boom was accompanied by a very risky borrowing policy, including its debt exceeding half of its budget revenues, something that the federal budget will most likely be forced to bail out. The region was responsible for 13% of housing erected in the country in 2007 (21% with Moscow included), meaning that the negative consequences of a recession in the construction sector and risks when buying an apartment could not be any worse. Slashing housing construction, which has also been rocked by the credit crunch, is also having a grave impact on construction materials enterprises.

The risks of an industrial recession and a rise in unemployment are higher for St. Petersburg and the Leningrad Region. St. Petersburg, the home of many large companies' registered addresses, has a budget that will also undergo some difficulties. Initial signs of an economic recovery for metropolises, however, point to them again becoming the leaders in growth; the agglomerative effect is stable.

Import-substitution regions, especially machine-building ones, are also connected to the world economy as demand for their products is secured by an influx of oil-dollars. Some of the leading machine-building enterprises belong to the large commodities sector, which is experiencing painful financial problems leading to a sharp cut in current support and investment. A drop in product demand has hit industry hard in the Nizhegorodsk and Ulyanovsk Regions, while Kaliningrad's industry, which grew based on industrial assembly, has seen the economic crisis spread to other regions of import substitution. The primary risks are in the employment sphere since these enterprises play a rather non-influential role in budget revenues, while these regions themselves are not developed. A sharp devaluation of the ruble in 1998 gave import-substitution enterprises a boost in growth, although a second coming of such a scenario is highly unlikely for politically reasons. There are, however, high risks of a drawn-out recession in machine building; workers are already being let go, though their numbers are not likely to exceed those of the 1990s.

Underdeveloped regions will fully depend on a federal budget that allocates 13–14% of its funds to inter-budgetary transfers. Gratuitous allocations for 17 regions in 2007 made up 50–93% of their budgets' entire revenues; for another 11 this figure was 40–50% of their budgets, giving almost a third of the country's regions being highly dependent on federal aid. Expenditure appropriateness is now paramount – since next year there may not be enough resources. Nevertheless, federal government employees had their salaries raised by a third; the same was recommended for the regions, although many of them rejected it. Risks of a growth in unemployment are not serious for underdeveloped regions. Studies in the European Union member states show that more developed regions with a low rate of unemployment are more sensitive to changes in the economic environment (when it worsens, unemployment grows, and when it improves, unemployment decreases), while regions with troubled labor markets are more stable since things cannot really get any worse.

The state of incomes is harder to evaluate because legal labor costs in underdeveloped regions are determined by wages in the budget sphere that hinge on federal transfers and the level of inflation, which is going to grow. From the look of it, the federal center's policy toward underdeveloped regions will be based on evaluating political risks; hence, supporting separate republics in the Northern Caucasus, primarily Chechnya, will remain a priority. In other words, in terms of interest and coalitions we can expect support for trends towards aligning the budget, which will hurt more developed regions.

Regional policy vectors

The state now has a tough choice to make: whom to help and how? The first question is whom, and the main dispute is whether to provide aid to business or the people – in geographical terms, since big business is concentrated in more developed regions, while 70% of the population lives in average to underdeveloped regions. Rendering large-scale financial support to business heightens the risk of running a deficit in the very federal financial resources needed for both social and regional reallocation policy.

This choice also hinges on businesses' staying power and the acuteness of the problem for people working in different sectors and living in different regions. There are more objective opportunities for service economies in federal cities to adapt, be it as it may that new businesses entering this sector (retail chains, financial sector and business services) will be forced to go through market restructuring and recession, and weed out less effective proprietors.

This process will be more problematic for regional centers where new businesses in the service sector are only now being formed, making them more vulnerable. Federal cities have budget cushions that they can utilize, and all other large cities have for a long time now been taking budget aid from municipal districts. Well-off home buyers and small businesses in all large cities are included in these risk groups. Institutional measures of support are needed first and foremost to resolve their problems. Legal small businesses, already burdened with inefficient institutions and paying bribes, will most likely not survive the economic crisis. If the state is incapable of decreasing the pressure on small business, then the latter will again be reduced to smithereens. This, however, only concerns retail and services. Without any improvements in economic-crisis institutions, newly emerging small business investment will surely become extinct.

Large export business has its assets placed primarily in more developed regions, though at the same time these regions include single-industry cities that will inevitably be afflicted by the economic crisis, just like these regions' budgets that rely on income tax. Large enterprises have already received state aid to pay for short term loans from western banks – money that does not reach the regions but which nonetheless helps maintain jobs at large companies with better assets in single-industry cities. The problem is much more acute for single-industry cities with worse-off enterprises, as their production could possibly be phased out. The people in these cities require special, large-scale support measures, coming mainly from federal aid, to prevent any dire situations.

Large import-substitution business (the military-industrial complex and machine-building industries) is one of the priorities of federal support. During a drawn-out economic crisis, however, there are not likely going to be enough sufficient funds for propping up the non-competitive machine-building industry. The situation will get worse for these sectors in single-industry cities, though in a slower manner, but will most likely not end up with state restructuring its bad assets. Drawn out growth of social problems over time in single-industry cities, many years of low-paying jobs, and peoples' experience in adapting to long-periods of unemployment experienced in the 1990s all provide good preparation for an economic crisis by employing the appropriate retraining, public works and social security programs with smaller budget expenditures.

Freezing large scale state investment projects, including many highly disputable ones in terms of their potential efficiency, especially expensive infrastructure and commodities projects in the Urals and Eastern regions, will be the primary lever for bringing a halt to the crisis. But this does not necessarily mean that all investment programs should go under the knife; during the Great Depression, both the United State and several European countries built roads that are still used to this very day. Residential construction and refurbishing and road construction programs could provide wages for desperate people in small cities and remote areas of the country. The masses of guest workers, otherwise being thrown out of the job market and possibly creating social problems, would be provided with work.

The second question is how? The problem in the most general sense has to do with reallocating recessionary expenses that currently to a great extent fall to the regions, where income tax, which serves as the budget's main revenue earner, is being slashed. Moreover, social liabilities and expenses – set to increase during the economic crisis – are concentrated on the regional and municipal levels. There are two possible solutions to this problem.

On the one hand, expenses can be leveled out by having partially reallocated tax funds for the regions, to give them the chance to resolve their own problems, which admittedly they understand better than the federal government. In turn, the federal government should take on the difficult task of coordinating federal and regional support measures by shifting some of the responsibility to constituent entities. Ultimately, this is the way for effectively decentralizing authority, which favors regions with better quality administration, and thereby improves the institutional grounds for subsequent growth.

On the other hand, federal resources can be even more heavily concentrated on the federal level and be controlled from above (for example, through subsidizing regions to balance their budgets and other non-transparent

instruments). But in this case we would see all responsibility put on the federal government and have the regions line up with their hands out. The majority of experts at the moment believe that the federal authorities will make the latter choice of further centralizing authority and resources, which leads to obscure and by no means effective decisions for supporting the regions. It needs to be understood that this choice would decrease more developed regions' potential for modernization.

The economic crisis's take-no-prisoners nature from January through March 2009 clearly indicates that it will be deep and drawn out. In these conditions regional economic policy is geared towards short-term goals for countering the crisis; refining regional policy is now becoming the topic of the future. We believe, however, that when implementing economic stimulus policy it is extremely important to take into account, on the one hand, the objective procedures for reallocating labor and capital and the regions' characteristics, while on the other hand not losing sight of the economic stimulus policy's long-term consequences.

The best-case scenario is that the economic crisis can help modernize some territories' economies, discover competitive regions and make institutional changes in relations between the federal government and constituent entities. Russia would as a result emerge from the crisis with a radical new platform for conducting regional development policy.

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Russian Development Strategy in Crisis Conditions

Russia's transition economy of the 1990s, based on a combination of rushed, belated, insufficiently thought-through and unbalanced decisions, progressed to a large extent intuitively. The subsequent economic growth, lasting from 1999 to 2008, allowed to choose a growth strategy for the foreseeable future, even though the realistic options on the table were not as great as once thought. In mid-2007 we analyzed four basic strategies: Inertia, Rentier, Mobilization and Modernization[19].

That being said, we interpreted the government's conscientious actions for securing the country's economic and social progress as being part of a growth strategy. Implementing any type of strategy is impossible without relying on particular social alliances that counter other coalitions that champion other points of view. A constructive, realistic growth scenario for the country that relies on each of the examined strategies will be conceived as the result of a combination of the conscientious and instinctive action from all groups of society.

Hence we should refer to the analysis of possible strategies/scenarios of social-economic growth that to a large extent are ideal analytical constructions. Implementing each strategic option, even those structured in thoroughly worked-through, detailed documents, will in actuality clash with various groups of society that to any given extent override the initial conceptualization. Our work, as part of continuing research, will examine how the global economic crisis impacts implementing the country's growth strategy.

Inertia

The inertia scenario is based on consciously refusing radical economic reforms and social innovations that treat the political and economic elite as an "undesirable, destabilizing factor. This scenario assumes the government using primarily tactical maneuvers between interest groups with economic and political stability (this being understood as the status-quo) taking priority over growth. Similar tactical maneuvers, should the resources be available, propose tossing them from one sphere to another without any concern for efficiency and long-term consequences.

[19] See: Coalitions for the Future. Russia's Development Strategy. / SIGMA, RIO-Center – Moscow, 2007, Shastitko, A., Afontsev, S., Plaksin, S., Structural Alternatives for Russia's Social-Economic Development// Economic Issues #2, 2008.

In an economic crisis accompanied by slipping economic trends, losses of economic players increase and the state is forced to spend its resources on propping up the economy, meaning that the inertia scenario somewhat changes. The measures to put out the fire and reactions to incoming cues are completely logical in relation to the fight against the economic crisis. The state refuses to implement radical reforms and social innovations, just like under a favorable economic environment. Instead, it tries to moderately use its manageable resources to steadily fulfill its social obligations and compensate for the growth in numbers of the needy by allocating budget resources to social needs.

Since the duration of the financial crisis is hard to predict, the goal of this scenario is to minimize current budget expenditures while simultaneously fulfilling the state's social obligations to the greatest extent possible within the current circumstances. Here we will see persistence in a relatively significant expansion of state activity with the majority of resources being oriented towards supporting groups that depend on the status-quo being maintained. This first and foremost concerns state support of large companies that were sources of significant budget revenue under a favorable economic environment.

Ignoring stimulus measures' long-term consequences is the primary problem of the inertia scenario during a financial crisis, as it is when the economy is growing. It would never be a stretch to say that the economy's post-financial crisis structure is currently unclear (including policy priorities), as a large number of private, local issues arise that need resolving immediately. Meanwhile, implementing any given measures in the long-term outlook could bring about consequences that significantly differ from their short-term effect.

The fact that the economic crisis by itself is a factor that obstructs conducting inertia policy should not be ignored. The inertia scenario, even as it is seen in the financial crisis (stressing minimizing current expenses), can be implemented only in the short-term.

Beneficiary (Rentier)

This strategy aims to centralize and reallocate revenue from natural resources through the state budget to improve people's standard of living. This option proposes to increase the state's de facto social service liabilities and build up the percentage of state spending (including for social needs and state administration) in relation to GDP.

This scenario's primary threat comes from a fall in budget revenues. The financial crisis coupled with cuts in state resources increases the number of those requiring social welfare.

A policy actively reallocating the maximum amount of budget funds towards social needs, however, can be conducted during the financial crisis. In other words, one can practically uncover the elements of this approach that imitate measures of the mobilization scenario – for example, conducting studies to find out the need for maintaining employment. Simultaneously, the commissions for ensuring a certain level of pay at enterprises are fully in line with this scenario.

Mobilization

This strategy sees the state reallocating resources on a large scale and concentrating them in priority initiatives (infrastructure, power, machine-building, nanotechnology, etc.).

The mobilization strategy remains just as important during the financial crisis as well. What is more, implementing it under a worsening economic environment is made simpler by virtue of the following circumstances.

First, in a favorable economic environment, consolidating industries controlled by companies with state investment required specially manipulating property rights in ways that were not always legal, or creating clearly preferential terms for individual companies that, under market competition, was at least a subject for discussion (and in some cases condemnation). During the financial crisis, with practically all free resources in state hands, just an increase in state contracts and an improvement in the terms for awarding them (e. g., increasing the share of advances) would be enough for state companies to acquire stimulus funds, through a virtual buy out, for private companies in the same sector.

Second, since a direct allocation of state resources is one of the main initiatives for propping up the economy, it would be enough to set separate criteria for them, which sound completely justified during an economic downturn (e. g., preserving employment, and thus social stability), but at the same time leave enough space for “administrative resource” to act as it believes best.

Third, even if aid is put into refinancing foreign debt (the amount of foreign debt is one of the reasons for the crisis spreading throughout the economy), debtor companies are doing in fact nothing more than switching over from one creditor to another – instead of being in debt to foreigners, they are now in debt to the state. Switching creditors, however, does not necessarily mean receiving an automatic debt-payment extension or having it annulled in full. Therefore, as long as the crisis continues, the pledged equity stakes during debt refinancing will be legitimately turned over to the state.

Fourth, overly concentrating authority in state ministries’ hands at a slow pace in order to eliminate any realistic or even apparent market crashes (e. g., through allocating resources through government banks), looks quite natural and logical to the public and even business.

This scenario’s main problems during the financial crisis are the same as in a favorable economic environment. The most significant are as follows:

- The dominance of state companies and companies with the state as a shareholder, as well as all other types of state involvement in the decision making process without strong public monitoring institutions, in the long-term will lead to resources being utilized inefficiently at the very least;
- Unilateral decision making conducted under pressure from various interest groups could result in further growth and strengthening of corruption;
- Allocating state aid with no strings attached gives an incentive to taking money out of the economy;
- Cues transferred from the top down will be distorted under a system of micro-management and limited monitoring opportunities for grass-roots organizations. Implementing top-level measures has a less-distorted effect, meaning that false expectations arise and trust is lost. This brings about subsequent additional expenses for ensuring coalitions’ commitment to working with the state.

This strategy as a whole can be implemented during the financial crisis without it leading to total disaster. The mobilization scenario saves select industries in a financial crisis, just as it ensures an enclave of modernization in a favorable economic environment. This strategy’s consequence is the mobilization method of strengthening economic decisions while enterprises aim at having their operations fall within the announced priorities, and not increasing economic efficiency. Therefore post-financial crisis growth will most likely be based on the mobilization scenario.

Modernization

This strategy foresees a step-by-step basis for creating public coalitions that support thoroughly modernizing institutional mechanisms responsible for innovation, the capacity of public institutions and state administration. Universal experience shows that this kind of modernization is only possible when there is extensive growth in private enterprise, which requires a competitive economic environment free of state regulation, a developed institutional, production and business infrastructure and high-quality human capital.

The modernization scenario does not become less relevant during a crisis. There needs to be a transparent institutional environment and a favorable investment climate, meaning active institutional reforms need to be made in order to win the investment battle inevitably set to begin at the start of economic growth after the financial crisis passes. What is more, the financial crisis could serve as a pretext for correcting the mistakes, by, for example, amending regional policy, and thinking over issues on financing the pension system, improving the quality of the judicial system's work, etc. In other words carrying out the measures that were long-needed even before the financial crisis hit. From this perspective the modernization strategy's implication does not change one bit. Modernization during a financial crisis assumes a prognosis of long-term consequences from the decisions made. This scenario also calls for preparing and implementing steps for the long-term outlook that will have their own role after the financial crisis passes, and drawing up measures for developing business rather than conserving the current economic structure.

The modernization scenario can also be exercised in conjunction with implementing a fiscal stimulus policy. Allocating aid to companies through drawing up a decision-making procedure with clear-cut criteria, rather than through individual agreements per each case, could be its critical initiative.

Another difficulty in implementing the modernization strategy during a financial crisis is that the primary groups that could make up coalitions for supporting modernization are just trying to stay afloat. Meanwhile, state bureaucrats who should amend the decision-making system are in a pretty favorable situation (at least as long as the state remains the economy's main source for available resources).

* * *

None of the strategies examined above can be scrapped a priori; each one of them ensures that the country, its economy, territory and people are preserved. The Beneficiary (Rentier) scenario is less likely to be implemented during a financial crisis; the three other ones' chances are not lessened. Each scenario sets the course for overcoming the financial crisis, yet the differences between them are seen in how they answer the following important questions:

- how long the financial crisis will last and to what extent does its length depend on enacted economic policy;
- where the selected strategic course for overcoming the financial crisis starts out for subsequent economic growth;
- how the economic development course will change in the post-financial crisis period as compared with the pre-financial crisis period.

How successful Russia's post-financial crisis economy will be and how trying will the losses be for various public groups fully depend on the chosen strategy. The likelihood of the mobilization scenario and the difficulty of crossing over to modernizing the economy both increase during a financial crisis when interest groups are fighting with each other. To be fair, it should be pointed out that developed countries do not have a procedure for cutting the state's role in the economy, one that has grown significantly during the financial crisis. As opposed to Russia, however, these countries have the developed institutional structure and decision-making system for offsetting state administrative decisions. We continue to believe that even though the likelihood of any modernization taking place has lowered, Russia has still not squandered its chance to modernize itself.

APPLIED ANALYSIS OF TOPICAL RUSSIAN DEVELOPMENT ISSUES

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Development Policy in Crisis Conditions

For the past two years, 2006–2008, Russia has been active in trying to implement an economic growth and modernization policy: an investment fund was formed from the budget in 2006, and in 2007 a national development bank was created, based on the Bank for Development and Foreign Economic Affairs – Vnesheconombank. The policy for Russia's long-term social-economic growth[20], designed in 2008, envisages an innovation breakthrough in the economy in the mid-term outlook that should be reached through modernizing key infrastructure sectors, developing competitive enterprises and increasing human-capital quality.

The global economic crisis, however, is heavily offsetting the state's economic policy, which includes immediate fiscal-stimulus measures and stabilizing the economic situation, rather than long-term or expensive growth projects, as high-priority. Further still, the economic crisis is causing greater uncertainty in investment decisions made on large-scale projects. When the economy is growing steadily, one can predict infrastructure demand and evaluate the positive effects from a finished project, while an economic crisis includes, on the one hand, a drop in infrastructure demand, and on the other, an increase in infrastructure costs because of the heightened costs in recruiting capital.

An economic crisis always creates conditions for taking radically new approaches to development and modernization. The following are several financial-crisis mechanisms that lay the grounds for new approaches to the issue of modernization:

- Firstly, an economic crisis quickly uncovers the most problematic areas in both infrastructure and the institutional environment. Take, for example, obsolete property and equipment in housing and public utilities that need replacing no matter the economic environment;
- Secondly, resource prices are becoming more expensive. The inefficient spending of funds amid a budget deficit and closed borrowing markets have a significantly greater negative impact on the economy than having available financial resources;
- Thirdly, if economic policy amid the financial crisis is concentrated only on short-term goals, the possibility of another twist in the crisis arising grows, since all measures will only have a short-term effect, thus not laying the foundations for long-term growth;
- Fourthly, projects increasing labor output in various sectors, and the economy as a whole, are especially important because market competition increases. This is observed in projects on energy efficiency and investment in education, scientific innovations, etc.

[20] Policy for Russia's long-term social-economic growth, MER, August 2008.

We believe that the economic crisis should be used for developing new priorities in Russia's growth policy. Budgetary and tax measures should be reviewed not only as a way to solve short-term problems, but as a chance to lay the grounds for the economy's long-term growth and modernization as well.

Carrying out growth projects in Russia during the economic crisis will only increase in importance, for the following three reasons:

First, infrastructure investment will create jobs and demand for capital-intensive industries while simultaneously simulating economic activity in the real sector, which together will have a direct impact on recovering from the financial crisis. State investments are the most effective multipliers in comparison with increasing any of the current expenditures. For example, state investments in European Union member states are 1. 06, compared with 0. 89 for current consumption or 0. 6 for labor taxes.

Second, infrastructure demand will grow as the economic crisis gets closer to its end. Furthermore, lack of infrastructure during a revival in economic growth can become a serious hurdle to quickly returning to a course for growth.

Thirdly, infrastructure projects on a whole during the economic crisis will cost less as labor and material costs have dropped significantly.

Meanwhile, completely new efficiency requirements, relevant entity selection and project enabling mechanisms are added to growth projects during an economic crisis.

Effectively selecting projects

Drawing up and applying clear-cut criteria for selecting projects in a transparent manner is the most important prerequisite for achieving efficient capital investment.

Systematically implementing a cost/benefit analysis is especially important. Costs and benefits should include both the monetary component and evaluating external factors that do not directly have to do with monetary costs or benefits.

Projects need to be as extensively discussed as possible, especially with stakeholders, who give the green light needed for being able to give a credible analysis of all of the project's effects.

Finally, having accessible project information for the general public is extremely important (e. g., posting complete information on projects' progress on the internet, as this eliminates any politicized, inefficient decisions).

Project execution mechanisms

Infrastructure investment efficiency can be heightened through choosing the appropriate tools for executing projects.

Experience in selecting and design management in the private sector needs to be used as fully as possible through public private partnership, laying the grounds for developing marketed infrastructure and offering infrastructure growth projects on the stock market.

Corporate structure and regulation in some sectors could possibly require a change so that new companies can carry out large investment projects.

Investment initiatives: new challenges of the economic crisis

Detailed quantitative analysis of the economic crisis's impact on the economy and supply and demand in key infrastructure sectors is needed to set possible growth policy initiatives.

The infrastructure sectors most in need of large-scale investment programs are as follows:

- Transportation infrastructure, especially roads;
- Housing and public utilities and heating and power networks;
- Energy-efficiency projects;
- Medium and small business development;
- Investment in education and healthcare infrastructure;
- Research-and-development infrastructure.

Applied economic growth research contends that investing in all the above-mentioned sectors has an extremely positive impact on long-term economic growth. The differences in the level of infrastructure development are explained by a 25–40% difference in the growth rates for countries with high and low revenues.

Thus growth policy during the economic crisis on the one hand lays the grounds for a quick recovery by stimulating real sector activity. On the other hand, only the appropriate growth policy can set the stage for long-term economic growth at a high-quality level for overcoming the recession.

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Competitive Policy in Crisis Conditions

The majority of experts do not consider competitive policy to be of principal importance in the economic crisis; favoring improving economic productivity for times when the economy is on the rise has lowered motivation for developing labor productivity and creating impetuses for effective reconstruction. The economic crisis has made it necessary to take stock of policy instruments, including ones that until now have not been utilized sufficiently.

Competition policy: its definition and place in socio-economic policy strategies

In the broadest sense competition policy's goal is to create an environment where each market player, including entrepreneurs and consumers, has enough opportunities to use its resources to the best of its abilities. Competition in the sense of having free choice should not be tormented by excess administrative red tape or unilateral actions from market investors or groups thereof.

Competition policy includes forward-moving methods geared toward creating and strengthening market competition, as well as protective methods designated at preventing restrictive business practices. Steps toward strengthening property and contract rights in the market are included among the competition policy methods being executed. Measures are being taken to cut expenses for businesses that halt operations or go out of business. Restraining restrictive business practices is one of the competition policy's protective measures be taken, which is aided first and foremost by applying anti-monopoly legislation.

The difference between active and protective measures of competition policy, from a market investor's point of view, is that active policy measures make competition more favorable and appealing, while protective measures lower the appeal of restrictive business practices.

Competition policy is not only one of the important economic policy initiatives for enhancing productivity in using available resources. It also can be used as a litmus test for making the distinction between conflicting economic growth strategies. Conducting competitive policy with both active and protective measures is a distinctive feature of the modernization scenario.

Competition policy conditions in Russia under a favorable economic environment

Restrictions and limitations in using competition policy instruments in Russian markets are as follows:

- The Russian economy's industrial composition is dominated by the raw material sectors or sectors with a low degree of processing. These sectors throughout the world stand out for their high concentration of production and restricted opportunities for new players to enter the market, and thus competition depends on strategic relations between market suppliers;
- The global markets' priority for Russian raw-material sector suppliers means that, on the one hand, even the largest companies inevitably run into competition on the world stage, but on the other hand they have extremely limited incentives for competing with each other in Russia's domestic markets;
- Mainly incomplete institutional reforms make up the measures for liberalizing the economy;
- Unjustified restrictions for allowing new investors into some markets on account of unjustified authorizations, unnecessary licenses or import fees are preserved;
- Industry structures remain dominated by large and extra-large enterprises among an insignificant number of small and mid-sized businesses.

Russian companies' low efficiency in being able to enter and exit the market is a reflection of the indicated threats and restricted business competition. The country significantly lags behind the majority of countries with developed and developing market economies. This is a result of the rather low intensity level in competition in all industries, both currently and potentially.

When touching on protective measures, not all the news of the past decade has been bad for competition policy; instruments for protecting competitive policy have been significantly strengthened over the past several years. This is first and foremost thanks to an increase in penalties for violating anti-trust legislation, thus allowing anti-trust policy to have a fundamental impact on market players.

The Russian government has also paid more attention to competition-growth problems, or at least removing the adverse effects from restrictive business competition. A program for advancing competition in Russia was starting to be drawn up even before the first obvious signs of the global economic crisis appeared in the autumn of 2008, indicating that the government was intending to advance business competition in the country.

Competition and anti-competition policy in the economic crisis

Analysis based on principles of strategic interaction demonstrates there is some uncertainty in amending competition during an economic crisis. On the one hand, incentives supporting an obvious and/or tacit collusion with the current number of market players are weakening. On the other hand, when demand drops, the impetus for new players to enter the market usually drops as well, not to mention that few potential competitors actually execute their expansion strategies. If the incentives for entering the market were weak in the first place, then this factor is likely going to be neutral in relation to changes to the competition situation.

At the same time it is absolutely critical that traditional state fiscal stimulus measures aid relaxing competition by supporting tacit collusion. Compensating companies' losses – in reality compensating slashed profits – for a tacit collusion participant makes deviating from it less appealing. Hiking import fees and non-tariff restrictions has the exact same effect by cutting incentives for new suppliers to enter the market, and thus blocking current market players from rejecting tacit collusion. Here it is critical that attention be paid to the fact that these state measures are not part of unique "built-in stabilizers". Hence any damage done to competition by the fiscal-stimulus measures during the economic recession is not compensated for by gains made from initiating competition policy during economic prosperity.

The economic crisis has substantive leverage on companies' efforts to distribute their efforts between increasing efficient resource use and pursuing revenue. Market players' relative gains increase when focusing their efforts on making revenue, thus during the economic crisis the likelihood that new regulations for restricting competition grow (usually motivated by wanting to protect Russian producers).

Competition policy reference points in the economic crisis

The competition policy's distinct feature is that its instruments and the ways they are applied, no matter the economic environment and phases of the economic cycle, are constant. A return to these principles and repeating the conclusions based upon them for modern Russia's economic policy is extremely relevant to the times.

1. Competition policy is becoming more relevant rather than less so during the recession given the Russian economy's structure and competition situation in domestic markets. Moreover, active competition policy methods impacting market players' incentive ex ante rather than trying to offset their actions' consequences ex post are an absolute priority.

2. Active competition policy's first thesis conclusion shows that revitalizing work towards extracting and constraining new administrative barriers from being created is a must. The method for analyzing the influence of legislative amendments and regulating separate groups' and society's gains as a whole can play a critical role in this context.

3. The second conclusion: that revising the current customs tariff regulations is necessary. There are a number of industries where competition could be jump-started by annulling fees and non-fee restriction for imports, albeit to a small degree. This includes industries based on exporting goods.

4. The economic crisis could require taking specific emergency measures for creating or reviving markets and cutting spending for potential competitors entering the market as much as possible. This is besides competition policy measures that could be implemented during a favorable economic environment. These measures include revitalizing small whole-sale markets and freezing the majority of market inspections (excluding those meant to prevent criminal groups from taking control).

5. Revising the volumes and principles for granting selective state aid is an important measure for preventing tacit collusion in Russian markets. If aid is inevitable, it cannot be included as being an important criterion for lower Russian producers' sales, because, as shown above, the disciplined players in tacit (and maybe overt) collusion would end up being the ones providing aid.

6. The correlation between the promised and the granted aid is yet another important issue. Promised state aid to compensate sellers' losses supports tacit collusions and aids maintaining price discipline. The sad part is that this effect nonetheless is felt regardless of the scope of aid actually granted. This is exactly why supporting competition interacting with group representatives actually understates rather than overstates the scale of promised aid by comparison with actually granted aid. The state must show much greater restraint when distributing aid guarantees so that prices are made more flexible.

7. Recommendations for the regulated markets include resorting, to a certain extent at least, to freezing fees on natural monopolies' services – one of the most productive methods used from 1998–1999. What is being referred to first and foremost are services being offered by companies with a monopoly.

8. No-one doubts that competition policy's main goal is to amend the definition of objectives for making decisions in the government. The prospects for competition policy and elements of the modernization scenario will remain murky until creating new businesses and jobs is affirmed as a priority (in contrast to supporting current enterprises, and thus limiting competition on the products and resources markets).

Crisis and Russian Social Perestroika

The constantly growing gap in living standards between various social and regional groups of the population was the biggest shortcoming in Russia's pre-economic crisis social policy.

Incidentally, there has been a steady growth in the difference in wages over all these past years as the healthcare and education sectors were being commercialized, which brought a virtual halt to social handouts. Studies by the Independent Institute for Social Policy show that from 2000–2007 there was practically no increase in the middle class, one that had very few representatives as it is.

Russia was divided into two primary sectors: roughly 30% of the population in the export sector (oil, gas, metals, banking and financial services and private education and healthcare networks), and the remaining 70%, which improved its financial standing only slightly through getting 'crumbs from the master's table. ' The latter, however, was left high and dry without comfortable housing, quality education or effective medicine. Extremely low figures on average life-expectancy and international comparisons in the quality of general and professional education refer to this as well.

Despite abundant budget resources, the share of GDP spent on improving human capital is 1. 5 to 2 times less than in developed countries.

These negative social trends indicate that Russia has not set up an appropriate reallocation mechanism for ensuring a balance between implementing the two founding social institutions: a social safety net and the market.

What's the point of the former?

A social safety net means that any member of society can rely on any type of support should he/she fall upon hard times. What is being referred to here is everything from a bowl of free soup and overnight shelters for the homeless to free and affordable universal healthcare. Having a full-fledged social safety net is a primary indicator of a functioning 'social state. '

In objectively viewing the social situation in Russia, it is obvious that the referred-to social safety net has numerous gaping holes. Here are but a few of them:

- Inability to afford even basic healthcare (half of the working population do not rush to see the doctor because of long lines or not having the financial resources to pay for an appointment);
- Satisfied demand for high-technology medical aid stands at no more than 20%;

- Two million children do not attend school and at least the same number can be classified as being uncared for;
- Lack of unemployment insurance;
- A degradation of mandatory pension insurance;
- A virtual disregard for building a medical-social system for caring for the handicapped.

It would seem that patching up all these holes is not compatible with market principles and should be done purely through budget approaches, though this is not so. Many social problems can be solved effectively using insurance. What is more, even purely budget approaches need to be joined with modern mechanisms to ensure that state expenditures are efficient. This, in fact, completely coincides with market mechanisms. We will try to show what we are talking about by using an example for resolving problems in the healthcare sector.

Russian healthcare is most likely the most disregarded part of the country's social policy. Here are several objective reasons for making this conclusion:

First and foremost, the Russian population's health is in dire straits; by comparison with not just developed countries, but developing ones as well, illnesses in Russia become chronic 15–20 years earlier, which then leads to a massive disability rate and premature death. What is worse, the morbidity rate is rising steadily: In 2001, for every 1000 people, 719. 7 were diagnosed with an illness for the first time. In 2006 this number grew to 763. 9. It is pretty obvious that the situation became even worse in 2007, particularly because of the 'Zdorovye' (Health) national project, which ran additional examinations that helped discover new groups of people with chronic ailments. The healthcare system does not carry the bulk of the blame for these depressing statistics; Russians lead an unhealthy, all-too-often asocial way of life, including an unhealthy diet, drinking non-potable water, ignoring physical fitness, drinking, alcoholism, smoking, drug abuse, etc.

Second, affordable, quality healthcare in Russia is at an unacceptably low level, as free medical services are steadily becoming a thing of the past. Research shows that people pay roughly half of all healthcare costs, 50% of which pay for being treated in in-patient clinics, 30% for out-patient ambulatory care and 65% for dentistry services.

Against this background it is simply perplexing that there is a complete lack of any strategy for creating a road map for saving the healthcare system and, in the end, the population as we know it. Now is the time to answer the key questions that will determine Russian healthcare's long-term future.

The first question: The fate of healthcare spending.

There are several positions here, ranging from a return to the Soviet system to forcible substituting budget financing with mandatory medical insurance (MMI).

MMI's primary advantage is that is creates competition for a patient's business, from an initial visit to therapeutic to high-tech aid. Private medical companies are hence brought into the mix to help these people make the correct choice, thus raising the quality of care given.

There are, however, some major shortfalls that have become exceedingly obvious after almost fifteen years of the MMI system being in operation. There has been virtually no success in implementing the system's budgetary healthcare advantage. There are several reasons for this:

- Under-developed private company networks that could be extremely effective intermediaries between healthcare institutions and patients;
- There virtually being no prospects for founding a competitive environment in medium and small-sized towns, especially in rural areas where there is practically no choice at hand – normally one single hospital or clinic that people can turn to for medical aid;
- A chronic lack of financing for healthcare along with there being no chance for increasing the uniform social tax, including parts going toward the federal and territorial funds of MMI[21];
- Artificial institutes for so-called payments for the non-working population that regional authorities deposit into the MMI system.

MMI has virtually morphed into the same kind of financing resource for healthcare as all other budget levels, although the single difference is that the former has the UST (Unified Social Tax), which is tied directly to target-oriented expenditures (pensions, social and mandatory medical insurance).

If MMI really is to act like an insurance program, it should fundamentally switch to a personalized account for earnings and expenditures, just as the pension system does. Then it would be clear how many times each and every one of us visited the doctor and the expenses that MMI covered. Thereby we could provide an answer to the primary question that should underlie any healthcare development strategy: how much money is needed to, for example, stop the rise in morbidity, disabilities and preventable deaths among the population?

[21] The January 1, 2010 government proposal to increase insurance deduction rates into the MMI system by 2% will obviously not be implemented because of the economic crisis and the grave danger of the additional employer payments' burden being too much for a worker with a cut salary.

Even introducing patient-specific accounting will not relieve the MMI system of its main problem – a lack of healthcare financing. MMI currently receives 3. 1% of the labor compensation fund, though this number is cut several times further after individual salary exceeds 600 thousand rubles a year. What is more, Russia's constituent territories make payments for the non-working population. In 2008 the MMI brought in about 240 billion rubles, or 20% overall from state healthcare expenditures. The remaining sum came from the federal (22%) and regional (58%) budgets.

In having practically provided a single-system for financing healthcare, could not some current budget expenditures for medicine be sent to MMI? Well, then we have to ask: what does insurance have to do with this? It currently works by the same principles that the budget does, though the only difference is that introducing MMI required recruiting private insurance companies and creating special federal and territorial MMI funds separate from the budget system (this had a positive effect in the 1990s in somehow ensuring healthcare's earmarked financing).

And if single-channel financing is to be ushered in after having righted the situation, is it to be done through the budget system? A state healthcare guarantees program is what is ultimately desired.

Today's state guarantees program is much too underfinanced. Even if it were to be financed in full, its worth for 2008 would have been 700 billion rubles, or roughly 4,500 rubles per person. Keep in mind that this pays not only for medicine, hospital food and equipment depreciation, but also medical workers' salaries, which currently make up more than 50% of the program's budget. Bringing salaries in the healthcare sector up to an average level throughout the economy would require an additional 200 billion rubles annually, thus increasing the program's worth to 900 billion rubles, or by 30%.

Healthcare's importance is rising among social priorities in developed countries with the emergence of new engineering challenges and social needs (an increase in the elderly population, new social illnesses, etc.). State financing in Western countries makes up 6–8% of GDP, with the countries of Central Europe (Hungary, Poland, Slovakia, Slovenia, the Czech Republic and Croatia) closing in at 5–7% of GDP. Russia's financing, on the other hand, makes up only 3. 5% of GDP, even with the "Zdorovye" national project. Thus, the following conclusion is offered: the state guarantees program should cost at least 7% of Russian GDP at least to have a chance at reversing negative trends in the nation's health and have a good chance at attaining stable

Does this mean that new approaches need to be mixed with old ones? No, not at all. Today's healthcare budget is completely compatible with the economic mechanisms in place that ensure that allocated funds are used effectively. Take, for example, per capita financing based on the standards for rendering healthcare and the transfer of some healthcare institutions' status to autonomous.

It is critical to note, however, that if 7% of GDP is spent on healthcare; the real effect will be felt only a few years after spending has begun. This should be kept in mind when drawing up the plans for the country's long-term development to 2020. Apparently the coming two to three years, but no more, need to be focused on universal preparations for reforms that will allow our healthcare system to be fully financed starting in 2011–2012. Only then will Russia have a good chance to make outward progress in its population's health and life expectancy by 2020.

What should be done with medical insurance? Anything and everything that is beyond the state guarantees program is the basis for the program's universal growth.

If budgetary healthcare will secure the above-described state guarantees program in the coming years, one will be able to refuse mandatory insurance. This will decrease the UST (single social tax) by 3. 1%, which will definitely make business happy, though at the same there should be a comprehensive program for giving incentives for having voluntary health insurance. At the moment, no more than 20% of the population is participating in this program, with nine out of ten people doing so through a policy offered by their employer as part of employee benefits. Therefore, the short-term outlook's primary initiatives are locked on stimulating voluntary health insurance spending by both individuals and legal entities (primarily through providing as many tax breaks as possible). There is some sense in introducing state co-financing for workers in line with a similar program for pensions. The goal here is to make voluntary health insurance a part of life in the middle class and all layers connected to it.

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Methods of Modernizing State Machinery

State administrative instruments

The state administrative reform process can be viewed as applying a certain combination of basic instruments that can be called ‘technical,’ ‘institutional’ and ‘personnel. ’

1. The technical instruments here are presented as the administrative techniques that streamline government ministries’ internal operating procedures, but do not concern the level and quality of political (strategic) decisions or executing orders from above in the most efficient way possible. These instruments concern primarily transferring business’s entrenched administrative techniques, such as personnel management, business processes, planning, outsourcing and performance contracts (for sub-ministry institutions and organizations) to state administrative practice. The techniques themselves are borrowed from modern management tools. Moreover, formalizing procedures and internally monitoring their execution is especially stressed. Thus, the technical approach influences real-life operations while significantly cutting expenses for interaction with the state but not subjecting the need for similar interaction to a serious analysis.

Trying to perfect Russian technical instruments has led to developing administrative regulations, formalized result-oriented administrative mechanisms, planning and budgeting. This instrument was applied in countries with developed state administration until a certain level of efficiency was achieved. This level’s limit was defined by characteristically high internal monitoring expenditures, but when this limit had passed, the transfer to the following type of instruments was made.

It seems that Russia still has some rather significant opportunities for using these instruments. First, technical-style administrative mergers are being implemented at a snail’s pace. Second, technical tools are mainly being applied through separate organs of the executive branch (this is predetermined by the very essence of these instruments), but are used sparingly in interdepartmental interaction, all the while a significant number of processes (especially in regard to ‘elaborate’ state services) in a separate state ministry are a part of more general interdepartmental procedures.

2. Institutional instruments call for creating stable public institutions for preparing and passing state administrative decisions, amendments to these decisions, procedures for them to be carried out by state ministries, and putting together publicly approved and supported feedback mechanisms. Developing these institutions includes partially replacing internal monitoring with stable forms of interaction between state ministries and civil society organizations (self-regulation organizations, non-profit organizations, collegial bodies, etc.) and sets up the procedures for extrajudicial and pre-trail appeals. Using institutional tools helps state bureaucrats be viewed as ‘hired managers’ and strengthens organized civil society groups’ influence on any political decision made in the judicial and executive branches of power.

This initiative, which is traditional for countries with developed state administrative systems, gradually squeezes out the technical tools. Administrative reform success as a way for increasing quality in state and budgetary services, slashing expenditures in interacting with the state and decreasing the regulation burden as a whole through an approach based on public monitoring, despite the relatively high implementation costs, is best in the long-term perspective.

These approaches are at work in Russia at present, be it requires public discussion when developing administrative regulations or creating public councils under federal ministries of the executive branch. This also includes attempts to include the Russian Public Chamber in government ministries’ decision making processes, analyze pieces of legislation, heighten the executive branch ministries’ transparency, have independent representatives of the public participate in certification committees for designating civil servants, etc.

3. Personnel tools are nothing new for Russia’s administrative system and entail supporting a stable administrative system for designating people in charge of work with a current administrative team and having clear-cut performance targets for developing (regulating) the spheres they cover. This means reallocating posts and powers between government ministries, including bringing in new ones without amending the essence of their operations within the given authority.

Procedures for organizing government ministries’ internal operations change exclusively at the initiative of a manager, only differing by discipline level; that being said, optimizing tools are used virtually not at all. Resolving individual administrative problems is based on new personnel appointments with a minimal reallocation of authority between ministries that are key in determining the administrator’s influence or a country’s administration evaluating the degree of importance for any given problem. Moreover, the state's authority does not change in the big picture and the expansion of authorities in separate ministries is not limited by society. For example, the traditional attempt to hold expenditure growth at its currently level leads to new forms of financing (federal task programs, national projects and other administrative and project templates) that essentially serve as an additional source of funds for government ministries' functions.

Concentrating decision-making authority on a personnel level without previously determined procedures and criteria lead to a greater likelihood of lobbying practices. Individual industry concerns during the financial crisis are easily traced to the government-passed Plan of Action for Improving the Financial Sector and Separate Sectors in the Economy.

Having no feedback with business organizations and civil society is another challenge to an administrative system based on personnel tools. As a consequence, there is a long, temporary period for adjusting the measures being implemented and a limited opportunity for objectively monitoring these initiated measures' implementation. A weakness in feedback during the economic crisis increases the risk of making critical decisions belatedly and losing control over allocated funds being spent efficiently

In implementing the above measures, one can make the conclusion that the primary risks in using a management system based on personnel instruments are connected with limitations of the administrative personnel who make decisions. These risks also can arise in an economic crisis through passing (or not passing) necessary, untimely fiscal stimuli, baselessly slashing the list of aid recipients based on interest groups' lobbying capabilities, and inefficient fund application.

A state anti-crisis management system

The characteristics of a state administrative system based on personnel tools is that decisions are not based on preliminarily determined procedures and determined decision-making criteria; rather, they are based on the point of view of the person delegated the right to administer the corresponding sector. Concentrating decision-making authority on a personnel level without previously determined procedures and criteria leads to a greater likelihood of lobbying practices.

Having no feedback with business organizations and civil society is another challenge to an administrative system based on personnel tools. As a consequence there is a long, temporary period for adjusting the measures being implemented and limited opportunity for objective monitoring of these initiated measures' implementation. A weakness in feedback during the economic crisis increases the risk of making critical decisions belatedly and losing control over allocating funds being spent efficiently. The current expenditure monitoring system can track only the purposes of funds spent, while officially implemented administrative and budgeting tools do not obtain the desired results because of an economic crisis.

One could admit that a radically different economic-stimulus system for making and implementing state administrative decisions is needed during the economic crisis. Such a system is based primarily on the wide use of institutional instruments. The current administrative system based on personnel tools is turning into one of the most serious risk factors for the country in recovering from the financial crisis.

The opportunity to amend the state administrative concept is directly connected with incentives for all concerned interest groups. What is more, radical changes take place in the goals (and therefore incentives) for all economic players; a state civil servant will strive to preserve his posts, spheres of responsibility and earnings resources. At the same time, the economic crisis gives more of a positive image toward working in the civil service for qualified personnel who have been let go from the business sphere. Therefore, the opportunity to maintain one's post in the civil service is in itself a serious incentive for carrying out orders. Having said that, the opportunity to make money under the table amid a weakened system is another incentive for new personnel to enter the civil service and for current civil servants to stay on at their posts. Implementing technical and institutional instruments should be accompanied by a system for compensating civil servants.

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Problems of Reforming the Russian Budgetary Process

The creation of a "budget aimed at results" (BOR) geared toward the social sector's economic results is included as one of the most significant, targeted institutional changes of the last four to five years. It was established as an alternative to estimated budgeting used for financing networks of budget organizations and institutions based on their level of expenditures from the previous period, and not on the results attained. Spent budget funds feasibility goals and how the result is reflected is the essence of the budget process in terms of its end result. Therefore, globally budget-process reforms are oriented at increasing yield from budget spending.

The budget reform process calls for a number of significant changes, with several of them on their own in certain cases being associated with the risks of cutting the quality of the state's ability to function. Working through resolutions within such changes presents a minimization of these risks; therefore, it makes sense to lay down the conditions for BOR's performance for creating specialized mechanisms that ensure working out and attaining formal budget-process rules. These rules minimize the risks of the state's performance being reduced and any significant, negative external effects from arising. Such mechanisms include:

- Controlling (forcefully) and stimulating mechanisms;
- Mechanisms for settling disputes and adapting ex post (foreseeing a centralization of external effects;
- Feedback mechanisms.

The indicated mechanisms together present the needed terms for BOR's performance. Their absence essentially means an imitation of budget-process reform. Strictly speaking, supporting BOR can be done in two ways: by using characteristic mechanisms for estimated budgeting or by using completely specialized mechanisms that neutralize risk failures in the state administrative system's functioning. An attempt to perfect the existing spheres not using a systematic approach is doomed to fail along with a probable drop in the state's functioning capacity.

Switching over to BOR without first resolving the above-indicated problems offers up significant risks for failures occurring not only in the system for financing budgeted institutions, but also in the state's execution of its main functions. Increasing ministries' autonomy during a switch to BOR with a high rate of corruption in the country, low-quality incentives and monitoring systems initiates a large break between civil servants' actions and public demands and an accretion of ministerial expenditures no matter the level of socially-significant goals attained. In other words, BOR, as an alternative to estimated budgeting under these conditions could be presented not as an instrument for increasing state administrative capacity and peoples' trust in state ministries, but as a reason for their deterioration.

The path toward reforming budget relations on both the federal and inner-ministerial levels depends on an array of factors. Political competition and the status of state finances serve as such factors for people making strategic decisions at the highest level. Risk connected to political and administrative liability is a significant characteristic for people making decisions on the investment viability of human capital specific to BOR and creating and supporting specialized mechanisms for administration and control. BOR's relative advantages in comparison with its imitations and estimated budgeting is also defined by the quality of the system analysis (internal and external with respect to a budget planning entity) of government ministries' performance, the rate of accountability to society and characteristics of the mechanism for forcing formal rules to be executed. Moreover, the higher the level of uncertainty and risk, the more likely it is that there will be a BOR imitation.

The problem of creating strong incentives in terms of inter-ministerial relations is made complicated by the lack of opportunities for switching to an alternative minister (and change in administration). This does not allow for a real threat of a change in party to be formed. This restricts the available mechanisms for protecting agreements (because contracts with legal validity are far from always being referred to), and therefore influences the choice's characteristics. Then, the higher the potential competition level, the lower costs of switching to an alternative party, the level of uncertainty and monitoring costs, the higher the incentives to execute special investment in creating the mechanisms for managing the corresponding BOR.

Reforming the budgetary process amid the economic crisis and drop in state export revenue

Five years of budget reforms during a significant budget net surplus, a surplus trade balance and growing reserves ended up creating new procedures and characteristics for forming budget requests and financial accounts for government ministries and the higher echelons of the state hierarchy. A number of so-called BOR implementation experiments at the ministerial level were conducted under the aegis of the Russian Ministry of Finance and Ministry of Economic Development.

Real changes inside the ministries during these experiments took place only if there were incentives for the administration. In all other cases, changes were simulated, while the experiment in the ministry ended up in the opening up of additional budget funds. Moreover, these incentives were not given by the ministries that led the experiments. Practice over recent years has demonstrated a significant increase in financing for a number of ministries without any changes in the list of their authorities or performance. These specific situations occurred for a number of reasons.

First, there are no reforms at this stage of the rigid link between the financial support for a head administrator of budget funds with achieved results.

Second, there are no actual mechanisms for monitoring the observation of BOR inter-ministerial procedures, mechanisms for evaluating capacity of incentive and financial planning systems and mechanisms for monitoring accurate information making its way up through the state machine's hierarchy. In these conditions simulating reforms looks for preferable rather than actual actions demanding the administration of a ministry's effort and attention (a ministry that usually emphasizes tactical, political goals), which conflicts with the interests of the majority of the ministry's arms.

The economic crisis and unfavorable environment in the export-resources market intensifies state budget restrictions, although talking about the formation of strong incentives and realistic action toward creating a budget-relations system that coincide with a full-fledged BOR does not seem possible for several reasons:

First, there has been a lack of attention to reforming the state apparatus during the financial crisis; the priority goals are to patch up all the holes. Moreover, there are no demands for drawing up and implementing forceful mechanisms for selecting discrete structural alternatives, which are the key element of generating state economic policy along with priority initiative for spending budget funds, while implementing tactical reaction policy.

Second, opportunities for resolving problems of adverse selection personnel in the state apparatus are limited during an economic crisis. The private sector injects sufficiently qualified workers into the labor market, but despite this, state structures can only absorb an insignificant piece because of restrictions put in place by current legislation on state service.

Third, intensified budget restrictions will escalate the fight for state resources between different interests groups. Referred to here are insiders, in other words ministry interests, and outsiders (a situation with displaced interest groups is also possible, especially when referring to a fight for funds from the state investment budget). The current level of financing and the list of projects and programs being implemented need to be maintained by the former. Having said that, when it is highly likely that the budget will be cut, the level of transparency drops through manipulating information and restricting/imitating functioning mechanisms of public control. The latter have to maintain the existing contracts and obtain new contracts. Here the decision-making process (both in creating the expenditure-structure process and contract selection process) is all the more subjected to pressure from external groups; the co-participation principle is used in conflicts with rental interests.

The economic crisis presents a dramatic choice between rejecting BOR principles (ones that still do not work and infringing on ones already being applied) and increasing efforts for intensifying reforms in the budget process. The first option for solving this problem has significant short-term advantages in allowing for quick reactions to any critical situations in the financial or other spheres, while also minimizing short-term costs. In turn, consistently implementing BOR principles will most likely present an increase in costs in the short-term without any guarantees of them falling in the long-term.

DYNAMICS OF THE SOCIAL CONTRACT: CRITICAL TENDENCIES

Alexander AUZAN

The year 2008 was marked by a series of events (the beginning of the global and Russian economic crisis, a war with Georgia and the amendment to the constitution extending the president's term from four to six years) that had an earth-shattering influence on the condition and behavior of the nucleus of the institutional environment and informal rules of hierarchy. The general context of the past 15-year movement of Russia's constitutional institutions needs to be characterized first to be able to evaluate these changes. Then one can interpret the changed conditions and consequences of a value choice that can impact the true perspectives for and type of Russian modernization.

1. Constitutional institutions: supply and demand

The social contract, spoken of very rarely, is not an exchange of commitments, rather an exchange of expectations of rights and freedoms. It regulates informal practices of a high order, what economists call 'non-constitutionally binding practices. ' The constitution may be a great thing, but when a formal practice encounters an informal one, the latter usually gets the upper hand. In the end, how this above-mentioned consent plays out in the social contract is the deciding factor in what will work in the Constitution and what will not.

The 1993 Constitution is the result of a compromise reached under critical political conditions and on the brink of civil war. It was passed under a state of emergency and was in no way the result of a social contract; although the compromises did include some assertions. For example, it contains a statement on the values that we have inherited from our ancestors – values of goodness and truth. The Constitution contains assertions of there being institutes based on individual freedom, those being social state institutions and the separation of powers. It tries to take into account the rut that Russia is stuck in to help it escape in shaping the assertion of a democratic state.

Now let us take a look at demand. All of today's stable democracies went through a restricted democracy or limited voting rights phase, where the right to vote was given out to select groups on a gradual basis. All of today's unstable democracies have not gone through this phase.

How is this explained from an economic point of view? Research shows that in different countries the demand for democracy depends on two factors[22]: having a certain level of material wealth and education leads to the population expressing a rather high demand for democracy. Why is this? Democracy is hard to get one's head around, expensive, and a thing of luxury, because taking part in democratic institutions demands significant amounts of time and intellectual effort.

What will happen now that there is little demand for democracy? The Constitution of 1993 lays out a democratic way for making decisions. If a citizen's income is below average and he/she makes a small contribution in taxes to the state budget, then the demand for free state aid becomes rational to the people – they decide that someone should pay for these social benefits while shuffling the responsibility for this onto others.

The seesaw situation starts to tip back and forth with populist offers or bribing voters with monetary investments.

Any further logic of the growth of Russian democracy involves the attempt to react to the problem of limited demand for democracy and the seesaw situation. There were various possible solutions, but we have seen two constitutional crises in the past 15 years; there have been public discussions on amending the Constitution in 1995–1996 and 2007–2008; having said that, we still have not overcome the second crisis. We had two systematic crises that were not always acknowledged – the 1998 default and the one in 2003 (linked to the Yukos affair, election manipulations and a turn to authoritarianism).

The supply of democracy has dropped; however, the supply of democracy is a factor in the growth of demand (from this point of view President Dmitry Medvedev's 2008 presidential address contained ten proposals for developing democracy, which are historical since they mean a distancing from the position that gives rise to vast inequality.

In a strange way the controlled democracy became the government's main problem because the controlled democracy disintegrates the separation of powers. In such an environment there is no functioning feedback, relatively serious reforms are impossible, and the delegation of power is made difficult. Look at how the crisis of the clashing elite in 1999–2000 was resolved: those

[22] Lipset Seymour Martin. Some Social Requisites of Democracy: Economic Development and Political Legitimacy // American Polit. Sci. Rev. 1959. Vol. 53. P. 69–105; Barro R. Determinants of Democracy // Journal of Political Economy. 1999. Vol. 107. No. 6. P. 158–183; Acemoglu Daron, Johnson Simon, Robinson James, Yared Pierre. Income and Democracy. Working paper. Massachusetts Institute of Technology, 2004; Acemoglu Daron, Johnson Simon, Robinson James, Yared Pierre, From Education to Democracy? // The American Economic Review. 2005. Vol. 95. No. 2; Polterovich V. M., Popov V. V. B. B. Democratization and Economic Development // The Social Sciences and Modernity. 2007. # 2. pg. 13–27.

who lost maintained their gubernatorial positions and parties in the State Duma. When there is no separation of powers, there are no branches for different elite groups to latch on to.

The year 2007 gave us the constitutional crisis – demand for political institutes was at a minimum; there is a personal warranty, but the person with that warranty (a guarantee) has to leave according to the Constitution. In this type of system the task is not completed. This is exactly why we have received the following construction: the shell remained intact, the president has left, but he stayed. The Russian Constitution was not amended in 2007, but the global financial crisis of 2008 changed conditions for making a choice.

In the summer of 2008 Russia passed a crossroads that gave the opportunity for modernization. This twist seemed no less important than the previous crossroads in 2003–2004. The year 2008 is just another crossroads and another lost opportunity.

2. Blurring the Rules and Choosing Values

Let us compare 2003 and 2008. Russia had its first asset separation complete by 2003, and then the crossroads appeared. In the 1980s the Martin McGuire and Mansur Olson[23] models showed how a social contract is being put together: the state plays the stationary bandit, and interest groups that are using the state split up the assets. When the primary assets are split up, the question of whether to set a new limit or try to create a new system of rules to set in motion a system for using already seized assets, which was the main issue in 2000–2002. This issue was resolved against the interests of a new system of rules after Yukos was seized and the parliamentary elections took place. The same Olson and McGuire models show that passing a new system of rules takes place on the condition that no new 'hungry' groups come about that contend for large assets. Back then they arose and the game hit a new level, which was completed by 2006–2007 when yet another crossroads appeared.

The political construction that arose in April and May testified to the fact that this problem had been acknowledged. While Putin's government was finishing its make-over, Medvedev's administration shaped an agenda for reinforcing existing property rights. There were obvious demands for the rules to be amended, but the cycle broke. Why? Were there new 'hungry' groups? – Probably not. It seems to be that something else has happened.

[23] Martin C. McGuire, Mansur Olson. Social Capital Formation, Income Redistribution, and the Form of Governance, Manuscript of September 25, 1992, Dept. of Economics, U. of California-Irvine, Irvine, CA. Delivered at Western Economic Association Meetings, June 1993, Lake Tahoe, CA.; Redistribution and Public Good Provision in Autocracies and Democracies: The Continuum of Regimes. IRIS, U. of Maryland and UC at Irvine, 1994.

In 2007 the problem of a third (presidential) term and amending the Constitution ended up with the Constitution remaining intact. This took place because it was critical for the dominating groups to preserve their share-capital in Russian, and especially foreign, assets, and the opportunity to enter transnational projects. This was not important anymore; however, in the summer of 2008, the economic crisis had come crashing down and foreign assets could be lost no matter if Russia followed the rules or not. Instead of refusing to play the reallocation game in favor of the asset-use rules, the game moved to new playing fields. It turned out to be possible to play this game on the international level and continue to build assets on the global level by breaking not just the economic rules, but also those of political institutes in the post-Yalta system. It would be incorrect to say that this is the direct intention of the Russian government, for it always defended the post-Yalta system; although it had very few prospects as it had been around for more than 60 post-WWII years in a world that had changed dramatically. The rules were blurred primarily by the West – Belgrade, Iraq and Kosovo were causes for breaking the rules. What can work well in chaotic conditions? – Russian bureaucratic capital: this no-holds barred game is our national sport. Therefore, it is understandable as to why the dominating groups rejected the notion of a demand for rights.

Then why was this accepted below? Sociology shows that an enormous wave of patriotic consolidation occurred during and after the Georgian war. If we compare this with 2003, the following took place: The central value of freedom in the 1990s, although this is contended, was virtually replaced by stability. What followed was the shaping of a full-fledged authoritarian regime (reaction often succeeds a revolution, because reaction has positive functions for re-establishing order).

What happened next? Stability began to crumble: first there was the inflation-management problem in 2007, and then in February and March of 2008 Russians began to save less than the norm set during the past eight years. Before this, people gladly put money away in their savings accounts, preferring stability to anything else; although people acknowledged that stability was drifting away even before the hardest blows of the global economic crisis had been suffered, a demand for other values arose. Sociology has clearly shown for a long time now that the second most popular value among the public was fairness, just as it had been in 2003, except that the latter became a perfect moment for manipulating the Yukos case and parliamentary elections. The demand for fairness was very close to the demand for justice that was put up by business and dominating groups (what is clearly being referred to here is rule of law and so forth)[24]. Fairness, however, was not the victor of this election: the idea of a great power became the dominant one in society.

Here a few things need to be analyzed, like the amount of patriotic consolidation, like in August 2008, that did not take place in Russia for the entire time that sociological observations were being made. What does this choice mean? Certainly it creates significant changes to the situation and influences the social contract.

3. Institutional traps of mobilization modernization

Now let us return to the prospects for modernization, since expectations for it can grow in both mass groups and administrators' rhetoric even during the global economic crisis (Soviet modernization is known to have begun under the Great Depression). But with this selection of values, what kind of modernization could we be referring to? This is the type of mobilization modernization that we have already gone through once before. They all have similar paths. Which ones you ask? A surge of mobilization resources, undermining human potential and demobilization.

Here is where we come across the problem of being stuck in a certain routine track: the country jumps up, hits its head, and falls down. In the end it attains the same result as during evolutional development – not very good, but things could be worse, only things are being achieved at the expense of losses, disappointed ambitions, etc. Let us take a look at the mechanism for keeping true to this path, starting with the economy: when the state works towards modernization, it uses its competitive advantage, seeing as how the state is an organization with relative advantages in applying force, which is a real advantage. How can force be used in the economy? Modernization can be executed using the means of mobilization – transferring assets, people and property. These methods sometimes happen to be productive.

This mechanism virtually binds together government and property, and from this at certain stages one can wring out a positive result, though the problem is what will come next. Such a combination enounced in institutes of serfdom and autocracy allow for a surge to be made through reallocation, but then human potential is undermined, which is the most elastic, and thus most important resource of this surge.

[24] Democracy: Developing the Russian Model. Edited by. I. Y. Yurgens // Institute of Contemporary Development, «ECONINFORM», Moscow, 2008.

Efficiency is unattainable with overly-soft budget restrictions tied to joint government and property, while over-using resources is inevitable. From here we have growth in the short-term and a fall in demand for demobilization in the mid-term. Demobilization can come about in different ways. Y. M. Lotman reasonably noted[25] that Russia was attracted to the idea of a social contract along with European culture. And if one is to free the nobility as was done in 1762, then the peasantry needs to be freed, be it as it may that the latter was done only in 1861. There were several demobilization steps made in the post-Stalin era: the beginning saw prisoners freed from camps, the nomenclature from the repressive machinery, and, by the time Brezhnev was in power, the peasantry was given passports.

Attempts, some being successful, are made at each and every demobilization stage to complete a socio-cultural modernization of the country, but why is Russia unable to move out of demobilization and over to another mechanism; what is keeping it from changing course to escape the beaten track?

First, there is a lack of social action during periods of liberalization and democratization, social capital accumulated (provisions for mutual trust are divided up) tapers off during reforms and it is put in group form with closed circles. Small groups that begin to deal in reallocation, while not doing any social good, arise easily. Negative incentives are applied by an organization with a wide number of groups, from which the mafia and state shoot up.

Second, values are important for accumulating trust, but when new values are being searched for, a change takes place very easily. The new state model is being hoisted onto the old pedestal – be it Soviet power or democratic power. It is not important what form the state is in when becoming a value. Democracy is not a value, but an instrument. And only by understanding this can something be done to develop democracy.

The state, in having become a value, takes responsibility for shaping modernized values; this explains why the state is able to achieve not only extensive modernization results, but intensive ones as well. All economists assume that creative labor cannot be controlled. A fear of death does not solve anything here; instead, the ideological factor does. D. Nort[26] proved

[25] Y. M. Lotman. The Contract and Saving Oneself as an Architypical Model of Culture // Y. M. Lotman. Selected articles: V 3 v. – V. 3. – Tallinn, 1993.

[26] D. Nort. Institutes, Institutional Amendments and Fuctional Economics. Moscow: Nachala Economic Book Foundation, 1997.

that ideology is an institute of short and medium-term use: when a certain set of values is at work, known economic laws can be broken and one can swim against the current.

Mobilized modernization is pretty likely (especially if the global economic crisis results in fragmentation and protectionist wars), but is not an inevitable outcome. Shifts in the social contract's structure continue under pressure from the economic crisis and can again change the terms for selecting a strategy.

The formula of the Putin social contract of 'political freedoms in exchange for stability' that has been followed in the past five years is unlikely to be restored. The expected length of the economic crisis leaves little hope of restoring economic wellbeing for the people in a timeframe that extensive groups see as acceptable. The economic crisis, in having overlapped from the stock-market and banking sphere into the real sector, and the prospects for a social crisis, will most likely lead to making such features of the previous formula obsolete, like virtual and tax-free relations between the government and people: institutional mechanisms for interacting with different social groups need to be restored immediately. The issue of distributing expenses from the economic crisis will raise demand for justice and solidarity as potential values for a new social contract. The probability of institutional modernization could once again grow significantly as part of a potentially new formula of 'Impartial order in exchange for taxes and citizens' participation.'

APPENDIX.

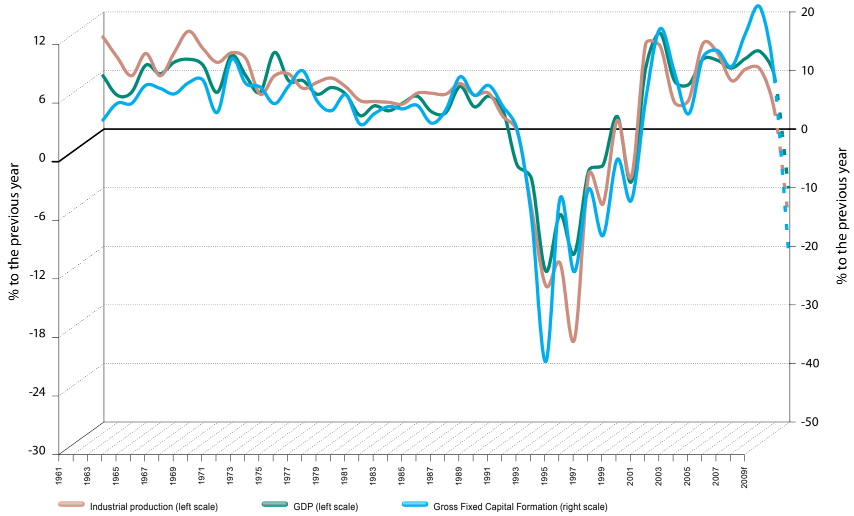
Russian Social and Economic Development Indicators

Table 1. Russia's Growth Characteristics, 2002–2008 (% of GDP, if not otherwise indicated)

	2002	2003	2004	2005	2006	2007	2008
GDP, bln rubles	10 831	13 243	17 048	21 625	26 880	32 987	42 469
GDP, bln US dollars	345	432	592	764	990	1291	1706
State foreign debt	30. 2	24. 5	17. 8	10. 7	4. 9	3. 6	2. 5
Private sector's foreign debt	13. 9	18. 5	18. 3	22. 9	26. 3	32. 0	29. 1
Central Bank's reserve assets	13. 8	18. 0	21. 0	23. 9	30. 6	36. 9	25. 0
Federal Budget							
Revenue	20. 4	19. 5	20. 1	23. 7	23. 3	23. 6	21. 2
Expenditure	19. 0	17. 8	15. 8	16. 2	16. 0	18. 1	17. 8
Deficit/surplus	1. 4	1. 7	4. 3	7. 5	7. 3	5. 4	3. 4
Banking System							
Banking system's assets	38. 3	42. 3	41. 9	45. 1	52. 3	61. 4	61. 0
Banking system's capital	5. 4	6. 2	5. 6	5. 7	6. 3	8. 1	8. 6
Loans to nonfinancial organizations	16. 6	20. 3	22. 8	25. 2	29. 9	25. 9	29. 1
Loans to private homes	1. 3	2. 3	3. 6	5. 5	7. 7	9. 5	9. 5
Banking system's foreign liabilities	3. 3	3. 5	4. 2	4. 9	7. 1	12. 4	12. 0

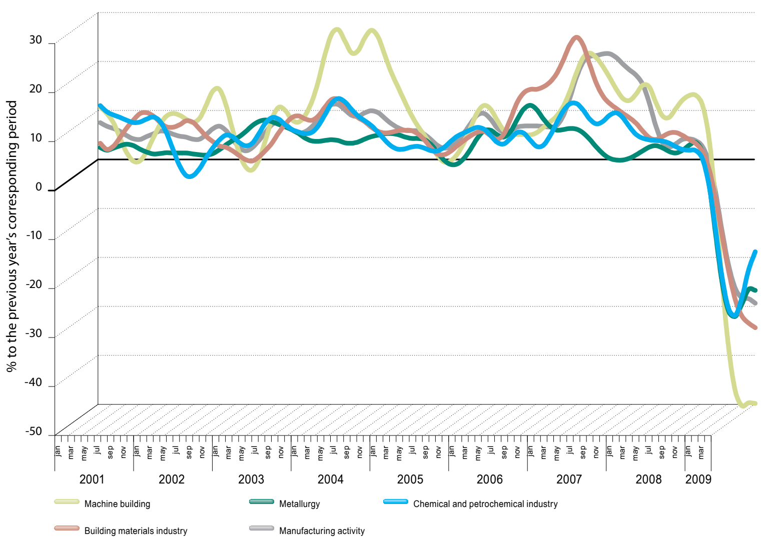
Source: Federal State Statistics Service (FSSS), Ministry of Economic Development, Bank of Russia, IEF calculations.

Graph 1. Economic Indicators' Performance in Russia (until 1991 – RSFSR), 1961–2009



Source: FSSS, Central Statistics Ministry of the USSR, IEF calculations and analysis.

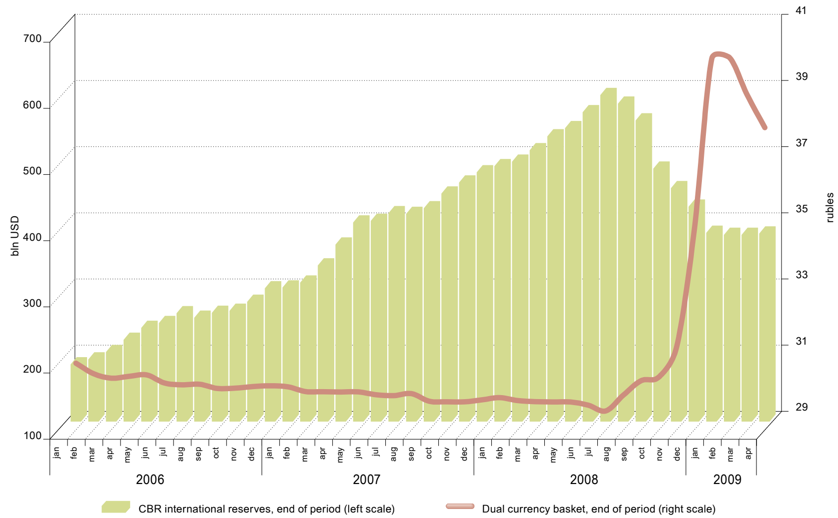
Graph 2. Industrial Performance from 2001 to April 2009



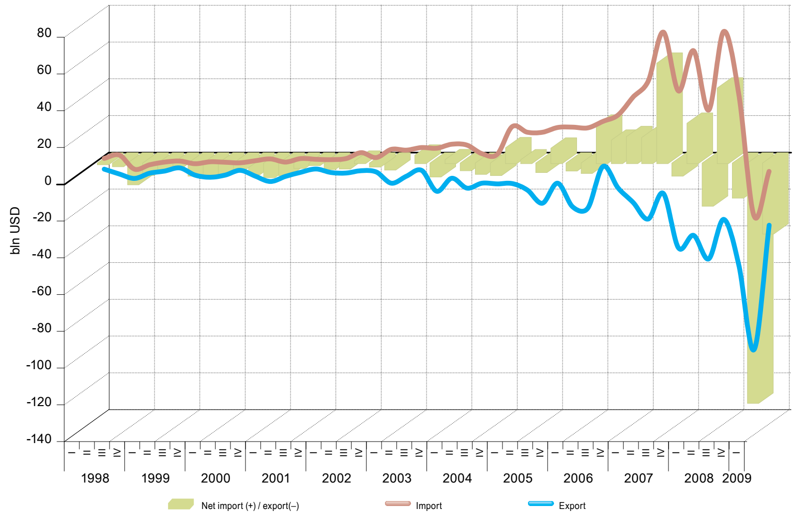
Source: FSSS.

Graph 3. Financiala crisis, 2006–2009

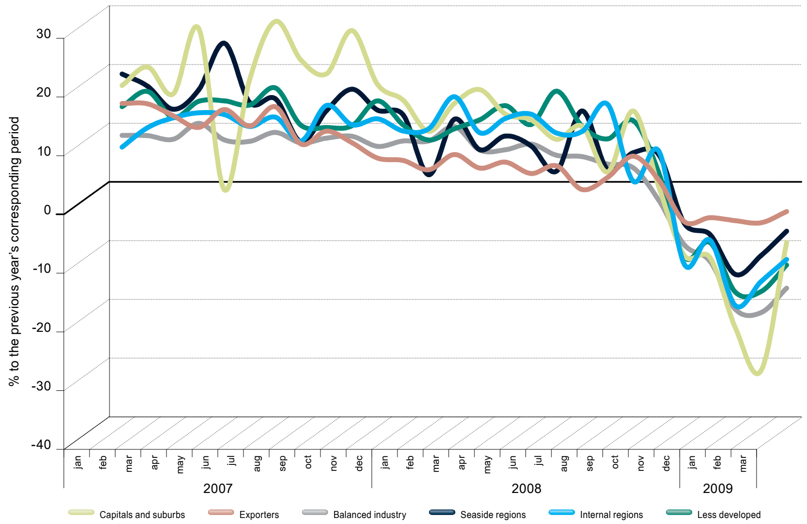
Graph 4. Dynamic of Currency Reserves, 2006–2009



Graph 5. Capital Flows: Export, Import and Net Flows, 1998–1 qtr. 2009



Graph 6. Industrial Performance by Regional Groups, 2007–2009, % from the Previous Year



Source: FSSS, IEF analysis.

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