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The Instability of Political Regimes, Prices and Enterprise Financing and Their Impact on the External Activities of the Russian Enterprises[2]

1 Introduction[3]

The level of Russia's trade with the traditional convertible currency countries was fast to decline and remains slow to recover. The apparently missing Russian supply response to officially declared trade liberalization and substantial rouble devaluation has been the subject of much speculation and of a notably smaller amount of analytical research. There is also much uncertainty about the exact state of Russia's rapidly evolving foreign trade regime. This is the experience of its foreign trade partners, both **ex ante** and more surprisingly, **ex post.** This must also be the experience of Russian traders. It is therefore of interest to ask not only how the rules have changed but also how Russian producers, buyers and middlemen have adapted to this rather peculiar case of administrative uncertainty.

It is worth emphasizing that during the last few years changes in the rules of the Russian foreign trade game have been highly significant in their depth and scope. Generally, they have also been in the right direction, if our admittedly imperfect understanding of the nature and causes of the wealth of nations is taken as a criterion of judgment. Foreign trade liberalization is one area for which the Yeltsin – Gaidar – Chernomyrdin administration can claim some, albeit only partial, success. Though matters may not have always developed the way policy makers and advisors would have wished, neither have they stood still.

A brief look at the state of Russia's (or actually the USSR's) trade regime with the West in 1991 should make this clear. This is done in the first section of this paper. Then, to illustrate the speedy and to some degree even chaotic nature of the transformation, the article provides a generalized overview to early 1994 of the ongoing change in trade rules. A subsection assesses the actual state of the trade regime in the first half of 1994. Further, the article discusses in a more systematic way some of the crucial issues of principle regarding Russian trade liberalization. Throughout, we discuss the adaptation strategies of Russian enterprises in the face of the economic, political and administrative uncertainty created by the

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[2] This article draws on Sutela (1993), which is partly based on Sutela and Kero (1993).

[3] A paper presented at the IIASA Workshop on "International Trade Issues of the Russian Federation", Laxenburg, Austria 5-7 May 1994.

character of change in the Russian foreign trade regime. The article ends with some conclusions and prophesies.

This article focuses solely on commodity trade and the exchange rate regime. Payment systems, capital flows and indebtedness are thus largely bypassed. Furthermore, the emphasis is on Russia's trade with the West, here understood as the traditional hard currency economies.

2 The roots of tradition: Russian western trade regime in 1991

2.1 The classic fundamentals

It is useful to start by restating the basic features of foreign trade in the traditional Soviet economy. (1) Foreign trade was seen essentially as a way of dealing with the residuals of overall planning. Imports were needed to overcome domestic supply bottlenecks and for technological innovation. Imports were not allowed to compete with domestic products. The general thrust was towards import substitution. Exports, on the other hand, were the means of paying for imports. Beyond that, and reflecting the deeply rooted psychology of a shortage economy, exports were considered as a leakage of much needed resources and commodities. (2) In order to maintain controls, concentrate expertise and exploit economies of scale, foreign trade was made the legal monopoly of state-owned foreign trade enterprises. Their activities were closely monitored and directed by foreign trade and planning authorities. Even minor questions were routinely dealt with at a high political level. (3) Domestic enterprises were effectively isolated from the direct effects of trade by separating foreign trade prices from domestic prices by means of a vast set of commodity- and country-specific price coefficients and by applying a highly arbitrary system of exchange rates. Foreign trade revenue was a major source of income in the general government budget.

There were amendments to these classic principles during the years of perestroika. From 1987 exporters were, as an incentive, allowed to retain a part of their foreign exchange earnings and to use them for imports within certain limits, mostly for consumer goods. The government also started giving trading rights to entities other than the traditional state foreign trade organizations. Further decentralization followed in 1989. The legal monopoly of the Vneshekonombank (VEB) in currency transactions was also abolished, as licensed banks were allowed to deal with foreign exchange. Foreign exchange auctions were established, though in practice they remained insignificant until 1992.

The reforms of the perestroika period did little to change the basic character of the Soviet foreign trade system. But they did imply increased opportunity for decentralized importing. Therefore, and as in other countries, these reforms very likely contributed to external disequilibrium and thus to the Soviet debt problem, which is essentially a creation of the perestroika years (Christiansen, 1993).

These classic characteristics of planned foreign trade have changed in a fundamental way in 1991–1994. Change started with the collapse of the USSR and has continued in Russia. This paper will argue that the Russian trade environment in 1992–1994 can be divided into three phases. The first half of 1992 was the period of liberalization. This trend was overtaken by a partial recentralization and stabilization of the situation from mid-1992 to mid-1993. After that, the macroeconomic policy of favouring rouble appreciation created a new environment and also a somewhat new dimension of uncertainty in Russian foreign trade. Its wisdom may also be questioned, and it is understood that real appreciation has for the time being been abandoned as a policy goal. Over a longer period of time, the rouble however still has much room for appreciation.

As background, one may be well-advised to bear in mind the words of Petr Aven, the Russian minister for foreign economic relations in 1992: "The historic role of Yegor Gaidar's government (at least as it was seen by its members) was to provide an "institutional shock" to the economy, i.e., to destroy the traditional stereotypes and mindset of the centrally-planned economy..."(Aven, 1994, p. 81)

2.2 Foreign trade in 1991 and afterwards

The year 1991 was one of deterioration, uncertainty and upheaval in Russian society, and its Western trade was no exception. According to official statistics, total Soviet exports declined by 32 per cent and imports by 44 per cent. This drastic drop in imports yielded a trade surplus but at a much reduced level of activity[4]. The decline continued in 1992. Export figures stabilized (and even grew slightly) only in 1993. The decline in imports continued unabated in 1993, and the Russian authorities originally reported a huge trade surplus of some USD 16 bill. This was later revised down to USD 10.75 bill[5]. In the second half of 1993, imports increased much faster than exports. This reflected a notable real appreciation of the rouble, as the nominal exchange rate was kept stable in spite of high inflation. During the first quarter of 1994, statistically recorded Russian exports continued their modest growth. As imports were 24 per cent lower than their level of the previous year, a trade surplus of USD 5.2 bill. was officially recorded[6].

The Russian foreign trade figures should be treated with great reservation, and indeed the downward revision of the estimate of Russia's trade deficit for 1993 is a graphic reminder of this. Another example can be cited here. According to Russian statistics, imports from Finland decreased in 1993 by about 57 per cent. According to Finnish statistics, on the other hand, exports to Russia exactly doubled. There may be some variation in the treatment of country-of-origin reporting, but probably most of the difference is due to deficient Russian statistics. Underreporting by exporters – largely for the purpose of hiding currency revenue – clearly increased already in 1991. Underreporting of imports can be explained by the use of capital flight assets in payment.

Measurement problems have been exacerbated by fluctuations in prices and exchange rates. Foreign trade shocks followed one after the other. Indeed, with a bit of imagination, one can argue that there has been at least one every year. First came the demise of the CMEA in 1991 and then the collapse of the USSR in 1992. The rouble zone had disappeared by 1993. The latter half of the year also saw real appreciation of the rouble exchange rate by some 150 per cent. This was partially compensated for by the abolishment of import subsidies, as discussed

[4] Aven (1994, p. 82) argues that the drop in imports was "the main reason for the decline of production in Russia in 1992", but I am not aware of any serious studies that break down the reasons for the decline in Russian production in 1991–1994.

[5] Finansovye izvestiya 28.4.-4.5. 1994.

[6] Reuters, 29 April 1994.

below. Finally, the price of oil almost collapsed in 1994, taking Russian energy export revenue down by some 17–20 per cent in the first quarter of 1994[7].

At the same time one should keep in mind that, on the whole, Russia has benefited greatly from improving terms of trade. The prices of Russian exportables within the former Soviet Union (FSU) were previously negligible and those in CMEA trade relatively low.

Overall, published Russian trade statistics tend to overestimate the drop in foreign trade turnover. Concerning exports, the actual decline that took place was concentrated in two sectors, oil and armaments. The slowdown in Russian oil production left the country with less exportables. The value of military equipment exports may have declined by more than USD 10 bill. in 1990–1993. The loss in Russian currency revenue was much less, as most traditional arms exports actually had the character of assistance.

The upsurge in Soviet debt and the decline in the currency income of the central authorities in 1991 contributed to the liquidity crisis of the USSR. The liquidity crisis had been developing over the previous couple of years, and additional foreign trade financing was generally not available yet in autumn 1991. In December 1991 Russia's net international reserves were close to zero. This, through the multiplier effects of missing imports and the expectations of domestic and foreign agents, contributed to turning the payments crisis into a structural solvency crisis. Russia is still to emerge from this misfortune. It should be emphasized, however, that this crisis is not of a global nature. Relative to most macroeconomic measures Russia is not a highly indebted country. If widely circulated estimates of the amount of currency that Russian residents have available have any factual basis, the Russian debt crisis is based on a serious problem in the relations between the state and the society, not on any innate problem in the economy's capacity to generate the revenue necessary for servicing the debt (Laurila, 1993).

2.3 Attempts at foreign trade reform

These developments cannot really be blamed upon a neglect of the foreign trade sector by Russia's decision makers. Even before August 1991, Soviet decision makers were highly preoccupied with foreign trade. In a clear break from earlier policy announcements, Prime Minister Pavlov emphasised repeatedly that Soviet integration into the world economy was both a short-run means of overcoming the economic crisis and a crucial long-run key to increasing competition, creating competitiveness and modernizing the economic culture as a whole. True, not all his pronouncements were equally reasonable. The Great Foreign Banking Conspiracy theme of the partial monetary reform of March 1991 was the foremost, but not the only, example of continuing xenophobic undercurrents.

[7] Reuters, 29 April 1994.

There was also considerable legislative activity concerning foreign trade in 1991[8]. The Supreme Soviet ratified various investment protection treaties. In July 1991, the Supreme Soviet also passed the Law on Foreign Investment, allowing both completely foreign-owned subsidiaries and concessions. The government's crisis programme of spring 1991 set the goal of making the rouble internally convertible (seemingly) for trade purposes by the beginning of 1992[9]. A presidential decree of May 1991 authorized all enterprises in basic industry to sell freely at home or to export 10 per cent of their output – but only provided that they had fulfilled the centrally drafted export plan and were able to secure the relevant licences[10][11]. As part of the general devolution of the USSR, the republics were also formally given more powers in setting quotas and issuing licences for exporting. The central authorities, however, tried to cling to the power of allocating the exports of fifteen main energy carriers and raw materials, which accounted for more than half the value of all Soviet exports[12].

But in spite of all the liberalizing legislation that can be enumerated, the fact remains that in 1991 the authorities still tried to control foreign trade very tightly. All traders still had to register. Registration now took place at the republic level, but this did not necessarily mean more liberalization. The same can be said of the 1991 devolution of the authority for setting quotas and issuing licences from the central to the republic level. In practice, exports were licensed only in exceptional cases, while import licences were pervasive[13]. This illustrates graphically the extent to which the behavioral rules of the deficit economy still prevailed. Controls were not only maintained for balance of payments purposes. They were clearly seen as a way of preventing commodity outflow from the country.

On the other hand, according to Petr Aven (1994, pp. 82–83), by the end of 1991 the scope of export licences for oil and oil products almost exceeded the quantities of oil extracted and refined in the country. The Gaidar government duly cancelled them all, thus signalling where the authority now resided.

2.4 Piecemeal evolution of the exchange regime

Traditionally, market-determined exchange rates were at best tolerated and at worst persecuted in the USSR. They were seen as the worst kind of speculation,

[8] For a complete listing of changes in the exchange and trade system in 1991 see IMF (1992a), Annex III.

[9] Ekonomika i Zhizn, 1991:18.

[10] Izvestiya 17 May 1991.

[11] The latter provision actually turns the general principle into an empty phrase. In truth, it should also be remembered that exports of produce in excess of the plan had been allowed earlier as well. By spring 1991 there were already some 25000 enterprises with foreign trade authorization, compared with the few score of foreign trade enterprises under the traditional regime.

[12] Izvestiya, 18 May 1991.

[13] I. Ivanov, Ekonomika i zhizn, 1991:1.

punishable under the criminal code. There was a huge wedge between market and official rates. Gradually, however, things began to change. After having introduced a "special rate of exchange" for tourism purposes in late 1989, Gosbank switched over to a currency exchange-based exchange rate in April 1991. This step was facilitated by the Currency Control Law of 1 March 1991. For the first time, this law authorized currency exchanges, thus undermining the prior official monopoly status of Vneshekonombank (VEB) auctions. By 1992 currency exchanges were already of major importance. Moreover, in June 1991 Gosbank started to quote a so-called "tourist rate of exchange", which was set between the prior official rates and unofficial market rates. Finally, in December of the same year, Gosbank stopped quoting the tourist rate and let the rate for cash be determined by banks licensed to undertake foreign currency operations.

These developments can be said to have introduced a very limited kind of convertibility for the rouble. One should keep in mind however, that two other important exchange rates continued to exist at the same time. The "official rate", which was totally arbitrary from an economic standpoint, was still used for statistical purposes and for the measurement of foreign receivables. The "commercial rate", which had been in existence since November 1990, was much lower than the "official rate", but still far removed from the market rate of exchange. In fact, during 1991 the difference between the fixed and market-based legal exchange rates widened, as a rapid increase in domestic liquidity resulted in a depreciation of market exchange rates. The difference actually became so wide as to become untenable. The unification of exchange rates was becoming not only economically rational but also administratively almost inevitable.

The commercial rate was used for converting foreign trade revenues and outlays into roubles. The rate was arbitrary, but introducing it was nevertheless an important step forward as it eliminated the jungle of thousands of commodity- and country-specific currency coefficients.

3 1992: Russian plans and reforms

3.1 The original Yeltsin reform manifesto

The dissipation of central control in the aftermath of the failed coup of August 1991 made it increasingly difficult to manage the external situation. Enterprises shifted foreign exchange deposits from the VEB to other banks. Capital flight evidently increased, partly as a response to very high currency retention quotas. The policies of the increasingly independent republics varied. There was no agreement between the republics about which government body was responsible for new external commitments. The creditworthiness of the VEB declined and finally foreign creditors even held back disbursements of credits already committed. As already mentioned, the country lost almost all of its official foreign reserves. In November the G7 countries agreed to defer principal payments on debt.

Two interpretative observations can be made. All through late 1991 and into 1992, actual government policies were determined to a greater extent by attempts to increase the amount of currency available to the central authorities for debt management than by any consistent policy aim regarding foreign economic liberalization and the opening up of the economy. It is obvious that this policy thrust was difficult to avoid because official reserves had evaporated as foreign creditors were anxious to get at least some of their money back. At the same time, however, the policies chosen for currency revenue centralization were such that they could not be implemented without giving enterprises strong incentives and abundant possibilities to circumvent regulations. There was much **de facto** devolution of powers to enterprises, but that was due more to the continuing deterioration of central authority than to any overall design. Perhaps these developments were simply unavoidable.

Russia became the actual centre of legislative power in late 1991. President Yeltsin first announced his economic reform plans in late October 1991[14]. The liberalization of foreign trade was to play a central part in launching Russia's transition to the market economy. This was a very important statement of principle.

In November Yeltsin issued a decree which came into force at the beginning of 1992 ("O liberalizacii", 1991). This decree gave foreign trade rights to all Russian enterprises. Though some 25 000 Soviet enterprises already had such rights in 1991, Yeltsin's November 1991 degree may be regarded as the demise of the state monopoly of foreign trade, one of the basic features of the traditional economic system. This decree is one of the most historic of the early Yeltsin administration.

According to the decree, foreign trade registration would no longer be needed. Some licensing would remain, but its scope, as regards both exports and imports, was to be narrowed. The remaining licences were to be auctioned among prospective traders. Fuels and raw materials would for the most part still require

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[14] Izvestiya, 28 October 1991.

licensing, both for exports and imports. Also, there would be certain commodities for which licences would be needed, either for importing or for exporting. Barter trade, which had been given more room in mid-1991, was again restricted. After all, it does not generate any currency revenue for taxation or confiscation by the central authorities.

The exchange regime was also overhauled. This time, all legal and physical persons were required to sell 10 per cent of their currency revenue to the Central Bank of Russia (CBR). Sales would be at the CBR market exchange rate – which then differend from the currency exchange market rate – and accumulated reserves would be used to support the rouble exchange rate. In addition, enterprises exporting energy and raw materials were required to sell another 40 per cent of their currency revenue, to boost Russian reserves, this time at a new commercial exchange rate. This rate was set so as to be disadvantageous to exporters, and so an element of confiscation remained. In the continuing deficit atmosphere, this requirement was meant to restrict exports of crucial resources. At the same time – given the predominance of energy and raw materials in Russia's currency earnings – such taxation was to be the mainstay of currency revenue for the central authorities. The remaining currency revenue was to be at the disposal of the enterprise involved, but was supposed to be deposited in a Russian bank[15]. The obligation to repatriate currency was formally decreed. Any currency deposits held by Russian enterprises in foreign banks were to be repatriated within three months. Not surprisingly, exporters did not obey the decree.

The only explicit restriction on the market exchange rate was that of a maximum margin for the bank of 10 per cent. Even very late in 1991, there were public references to introducing convertibility for current account transactions by 1 January 1992[16]. Later, this goal was postponed to March–April 1992[17] and then to a later date. This probably did not enhance the credibility of the Gaidar team.

The November decree annulled import taxes until July 1992. On the other hand, new export taxes on energy and raw materials were introduced. Some of them were soon found to be so prohibitive that they must have arisen from a miscalculation (as admitted in Aven (1994), p. 86–87). By February export taxes had to be changed. This was to be but the first in a series of frequent readjustments of foreign trade rules which foreign partners soon found to be not only irritating but also a true obstacle in trade relations. The attitude of domestic traders cannot have been all that different.

[15] Rossiiskaya Gazeta, 7 January 1992.

[16] Yegor Gaidar in Pravda, 5 December 1991.

[17] Gaidar in Izvestiya, 24 December 1991.

3.2 The policy memorandum of February 1992

In late February 1992 the Russian government published[18] its first comprehensive economic programme, a Policy Memorandum submitted to the International Monetary Fund, as further proof of the reformist credentials of the administration then negotiating for membership in the Bretton Woods institutions.

Rereading the Memorandum some two years later makes for a quaint experience. It stated that Russia would switch over to a dual exchange rate system by 20 April 1992. A floating rate would be used for current, transfers and a separate fixed rate would be used for capital transfers. Later, Russia would unify these two exchange rates by pegging the then floating rate. Currency taxation would also be overhauled. After the introduction of the dual exchange rate system, exporters would be obliged to sell 30 per cent of their currency revenues to the state. In addition, there would be a 20 per cent export tax – payable either in roubles or foreign currency – on all currency revenue. All export quotas, with the exception of those for energy carriers and certain military-related commodities, would be abolished by 1 July 1992. Export quotas for energy would be abolished in steps by the end of 1993. A flat import tax of 15 per cent would be introduced by 1 July. At the same time, all remaining quantitative import restrictions would be abolished. Finally, by 1 June 1992 import commodities would, face VAT and excise taxes.

It soon proved impossible to abolish export licensing and quotas as planned. Most exports continued to be subject to quantitative restrictions. Manufactured goods were the main exception. This was deemed unavoidable, as the domestic prices of energy and raw materials were kept well below world market prices. In early 1992 the domestic price of energy was only about 2 per cent of the world market price level. It rose to about a fourth later in the same year, and remained at that level until 1993. For many other raw materials, domestic prices were notably below world market prices. In some cases domestic prices tended to diverge further from world market prices (Gavrilenkov, 1994).

This made the export of Russian commodities an extremely lucrative business, and there was some concern that a sufficient supply in the domestic market could only be secured through quantitative restrictions. But as the difference between prices remained, setting a licensing authority between domestic and foreign markets created a situation that was bound to maximize corruption, smuggling and attempts to circumvent foreign exchange revenue repatriation, surrender and taxation. Early attempts to introduce effective controls proved half-hearted and futile.

In early May the Russian government caused considerable confusion by announcing that the rouble would me made convertible on 1 July 1992[19]. This was meant to be the centrepiece of the second phase of Russian reform, that of privatization, convertibility and (later) structural change. Domestic liberalization and economic stabilization were thought to be tasks that had already been essentially completed.

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[18] Rossiiskaya Gazeta, 28 February 1992.

[19] Financial Times 6 May 1992.

It was widely assumed that this announcement would in practice concern current account convertibility for residents. The rouble would float for the month of July, and a unified rate of exchange would be fixed on 1 August. Earlier plans for a special exchange rate for investment thus seemed to have been abandoned. Government spokesmen cited SUR 80 to USD 1 as the level at which the government wanted the exchange rate to stabilize[20]. The Russian government presumably was counting on the use of foreign support in creating a suitable exchange rate[21]. This, however, is not the usual conception of currency stabilization funds. They are used for creating confidence and for defending a feasible exchange rate against speculative attacks, not for creating an exchange rate regime. In the Russian case as well, foreign support was not to come forth for the latter purpose.

3.3 1 July 1992: the second stage of Russian transformation?

In May 1992 the Russian Ministry of Foreign Economic Relations issued a policy paper outlining its plans for the rest of the 1992–1993 period ("O strategii..." (1992)). While reaffirming its commitment in principle to foreign trade liberalization and restating many measures already announced, this policy paper clearly signalled a willingness to backtrack on foreign trade reform. Political pressure for reintroducing export controls had become too strong. Citing the overriding cause of economic security, the paper proposed the recentralization of exports of "strategically important raw materials", alleging that they were being dumped at too low prices by inexperienced local companies hungry for hard currency. The practical consequences of export liberalization were thus proving to be frightening. Concentrating "strategically important raw material" exports – making up an overwhelming share of all Russian exports – in the hands of experienced foreign trade organizations authorized by the Ministry would assuredly also help to end capital flight. The argument, presumably, was that controlling a much smaller number of exporters should be easier.

President Yeltsin promptly signed a decree to just such an effect[22]. Strategic raw materials which could be exported only by entities authorized by the Ministry were to include energy carriers, metals, timber and certain chemical products. It was planned to shorten the list of commodities traded on a quota basis so that by the end of 1992 it would include only gas, oil and oil products. Nevertheless, the Russian foreign trade authorities admitted that such licensing of exporters implied "a step backwards"[23]. Not surprisingly, the promised radical shortening of the list of commodities to be licensed and traded under quotas did not take place on a

[20] Apparently the government had to change its target exchange rate in spring 1992. As late as March, they allegedly had in mind an exchange rate of SUR 30 = USD 1.

[21] Kommersant 1992:19.

[22] Rossiyskaya Gazeta 18 June 1992.

[23] Petr Aven in Izvestiya 29 June 1992.

sustainable basis in 1992 either[24] or in 1993. By 1993 such "strategically important export" covered some three fourths of all Russian exports.

Petr Aven in retrospect argues that the separate handling of "strategic exports" was not only a step backwards but also a mistake. Once the principle had been admitted, it proved impossible to keep the list of strategic items short. Overall, his policy-making experience underlines the need for Russian liberalism: "... any obstacle to economic activity,..., will be circumvented in Russia, and therefore, this country has to be more liberal than any other" (Aven, 1994, p. 91). This is a strong argument. Trying to do what is impossible hardly makes sense. But the counterargument is also somewhat self-evident. Is "any obstacle" really circumvented? And if the state has few capacities, should one totally exclude the possibility of developing them?

It has been argued that the pettiness of Russia's foreign creditors in 1992 contributed in an important way to the failure of reform policies. Instead of providing ample financial support, the creditors concentrated upon trying to recover at least part of their receivables. Attempts to garner currency revenue were indeed again high in the mind of the Russian government by mid-1992. The practical implications of this were not favourable for the mainline of market-oriented reform. On the other hand, foreign debt servicing concerns were hardly the only ones bearing upon policy outcomes. As emphasized above, maintaining the wedge between domestic and world market prices made the complete liberalization of foreign trade impossible.

July 1992 also brought the unification of exchange rates. A large number of different exchange rates for the rouble still existed in the first months of 1992 (Alexashenko, 1992; IMF, 1992b). (1) The old **official rate** of about 0.6 roubles to the US dollar was still applied in the valuation of external assets. (2) The central bank quoted on a weekly basis **the CBR market exchange rate**. Ten per cent of currency income was to be sold to the CBR at this rate to support official intervention in the currency market. The CBR market exchange rate was to reflect supply and demand on the interbank market, but the exchange rates were not identical. Neither was there a clear rule for the relation between them. (3) A special **commercial exchange rate** (SUR 55 = USD 1) was set by the CBR. This rate was used for the compulsory sale of 40 per cent of currency revenue by most (energy and raw material) exporters. Because of its low level, the application of this exchange rate amounted to a tax. (4) Importers of necessities were, on the other hand, heavily subsidized through the use of a special exchange rate for **centralised imports**. It was set at SUR 5.4 = USD 1. (5) An exchange rate of SUR 10 = USD 1 was applied to tax payments by Russian citizens with incomes in hard currency. (6) **The interbank market exchange rate** was first determined in the weekly currency auctions held by the CBR and later in the Moscow Interbank Currency Exchange (MICE). This market remained extremely thin, with relatively heavy CBR intervention and increasing restrictions on access. (7) As the MICE was not active every day, banks were also allowed to trade on behalf of clients on inactive MICE days. The ensuing **interenterprise market exchange rate** tended to differ from the interbank market exchange rate, though in early 1992 it was administratively linked to the latter. (8) Markets 1 and 8 were for non-cash money. A separate market – subject to a maximum spread of ten per

[24] See the decree published in Rossiiskaya Gazeta 17 November 1992.

cent – existed for cash, mainly for tourism. Cash and non-cash markets thus continued to be segmented, and the exchange rates varied widely, although the difference was generally becoming narrower by summer 1992. (9)–(10) Furthermore, illegal **black market exchange rates** also continued to exist for both cash and non-cash money.

None of these exchange rates was generated by efficient or even well-functioning markets. During the early period, the MICE attracted at most a few per cent of all Russian currency revenue. Entry restrictions abounded and the exchange rate was maintained by CBR intervention. The interenterprise market was almost negligible due, among other things to the notoriously slow interbank system.

After July the CBR only quoted one exchange rate, based on the Moscow interbank currency exchange. The original intention of pegging this exchange rate after floating the rouble for only one month had to be dropped. But instead of appreciating, the rouble depreciated further, to SUR 450 = USD 1, already in late November 1992. Neither could the rouble be made into the only legal tender in the country. In fact, the legal scope for using other currencies in Russia was widened, until their use in cash transactions was outlawed at the beginning of 1994. Finally, the rouble was not formally declared convertible, though the issue is largely a matter of convention.

As MICE gained in importance, the market had to be developed. A larger share of currency revenue was duly channelled through the domestic currency market. Since 1 July 1992, exporters have had to sell 30 per cent of their currency revenue to the CBR. Another 20 per cent must be sold to buyers in the currency market. The good news for exporters was that sales to the CBR were no longer made at an artificially low special exchange rate, but rather at the market rate quoted by the CBR.

The idea of switching over to 100 per cent compulsory sale of currency revenue has been widely debated since the 1992, but the proposal seems to have been dropped for the time being. If this measure were to be accompanied by true buyer access for enterprises to currency markets, currency convertibility, according to one interpretation, would be realized. On the other hand, opponents of this measure suspect that announcements of such access would not be credible. The measure would then amount to total confiscation of currency revenue and would lead to still larger capital outflows. Even if such an extreme case would not come true, full currency surrender is hardly a desirable policy in Russia. Given the existing exchange rate uncertainty, a full surrender requirement would probably drive much trade underground. The CBR caused exporters notable losses already in 1992 through its slowness in currency transactions.

Taxation of foreign trade was also changed in summer 1992. Export taxes were adjusted and, at least in the case of energy carriers, increased. The average export tax after the adjustments was probably around 20 per cent. Barter was subject to higher taxes, which were later to be increased further. Instead of the 15 per cent import tax planned earlier, most imports were subject to a tax of 5 per cent in the second half of 1992. It was planned to raise this rate on average to 10–15 per cent at the beginning of 1993. Importantly, taxation was now to be at the market exchange rate.

The introduction of import taxes naturally tended to make imports more expensive. At the same time, Russia adopted the value-added tax in respect of imported goods, which had previously been exempted. However, the greatest potential influence on domestic cost levels came from the abolition of the previously depressed special exchange rate used in pricing centrally managed imports (such as grain, meat, medicines, baby foods, machinery for light industries). This hidden subsidy, which was estimated to amount to 4–5 per cent of GNP in 1991 (Alexashenko (1992)), was now in principle abolished by adopting the CBR market exchange rate for these transactions as well. The future of such subsidies was widely debated. It was finally decided that the system of commodity-specific currency coefficients – one of the cornerstones of the old foreign trade system and an important form of subsidies – should be maintained until at least 1996[25]. This was not done however in the traditional form, but by establishing commodity specific subsidies for centralized importing.

As Christiansen (1993, p. 12) emphasizes, the system of import subsidies was administered according to the traditions of central planning. The administration estimated domestic needs for centrally imported goods by enterprise, sector and region. Import decisions were made and goods distributed accordingly. Enterprises paid an average only 5–10 per cent of the value of centralized imports in domestic currency. This was a major source of inefficiency and tended to boost import demand. Import subsidies in principle amounted to a continuation of the multiple exchange rate regime.

In 1992–1993, this decision was a major eyesore of reformers and the source of huge subsidies, amounting in 1992 to perhaps 15 per cent of GNP (Easterly – Vieira da Cunha, 1993). In 1993 import subsidies were cut sharply, perhaps to less than a third of their previous level. In November 1993, when the government was temporarily free from parliamentary constraints, it was decided that import subsidies were finally to be abolished on 1 January 1994. Only minor exceptions – for baby food and medicines – would be made.

3.4 The year 1992 in Russian foreign trade rules: an overview

There is no doubt that the decree of 15 November 1991 on the liberalization of foreign economic activity was an important step. It abolished the need for specific foreign trade authorization. Six months later, however, licensing was reintroduced for the bulk of Russian exports, as new traders were judged to have neglected Russia's economic interests by selling commodities that were in short supply domestically, by setting prices too low, by competing excessively with each another and by neglecting to repatriate currency revenue.

The backward steps described above were rationalized in 1992 by referring to the need of foreign trade coordination and structural policies (Aven et al, 1992). Russian realities were however far from any Far Eastern models. Corruption, smuggling and circumvention of regulations abounded. This is to an extent a natural consequence of partial liberalization. Even more, it is the product of failed stabilization. A strongly negative real exchange rate made capital flight inevitable, while the soft budget constraints of enterprises further depressed the exchange rate, as huge industrial subsidies ended up invading the currency market in search of a safe haven.

[25] Nezavisimaya Gazeta 9 October 1992.

Overall, it is clear that trade reform in Russia stalled in mid-1992. Thus, we can mark the end of the first phase of Russian foreign trade reform. At the same time, however, the uniform exchange rate regime was introduced and maintained – though with the important exception of import subsidies.

Since the first half of 1992, quantitative restrictions have covered at least 70 per cent of all Russian exports. Though certificates carrying the right to licences can be traded, such trading seems to have been exceptional. An even bigger obstacle to free exports was posed by export duties applied to about 400 products, especially because their levels seemed to be totally arbitrary. This necessitated further changes in regulations, which only added to the uncertainty. Also, many enterprises, regions and industrial sectors have received tariff exemptions from the government. Such exemptions were granted on 61 occasions during the most reformist Russian period, the first half of 1992 (Aven – Glaz'ev, 1992). Altogether, they may have covered more than half of the total value of all exports subject to tariffs.

The inability of the authorities to monitor payments was a major problem contributing to capital flight. There was no effective means of comparing customs and banking records, and even relatively simple measures to monitor real export flows were not implemented. A currency control authority was established, but was not given personnel or offices. It was then abolished, and a new authority was established at the end of September 1992[26]. It was only in early 1994 that foreign bankers saw signs that currency controls might be starting to bite.

Neither was the customs border effective. In the first half of 1992, the Customs Committee may have covered scarcely more than half of Russia's total volume of foreign trade. One gets the impression that improving the actual control of foreign trade was not high on the authorities' priority list. Commercial banks did not report their foreign rouble depreciation to the CBR on a regular basis. With strong inflationary and rouble depreciation expectations, the repatriation currency revenue did not seem rational. Moreover, the crisis of the Vneshekonombank certainly contributed to the loss of confidence in the domestic banking system and in the ability or even willingness of the authorities to safeguard deposits held by Russian banks. A simple partial solution to the overcoming the loss of confidence would have been to allow foreign banks full operational rights in Russia. This measure has however been fiercely resisted by Russian banks wary of competition.

3.5 Why no surge in exports?

So far, the Russian export performance deviates clearly from that of many developing countries undergoing trade liberalization. Often, the most astonishing goods find their way into exports after liberalization and sufficient devaluation. Such exports have yet to emerge in Russia, with the obvious exceptions of aluminium and certain other raw materials. Several explanations for this anomaly come to mind.

[26] Delovoy mir 20 October 1992.

First, the general deterioration of the Russian economy is of such a character that while producers have problems in maintaining production, there has been no real need to try to avoid bankruptcy by searching for new markets. The threat of bankruptcies has not become credible, and there has been little need for either destocking or longer-term export strategies. Second, the traditional problems of product quality remain. Third, the export infrastructure, from communications to expertise in servicing, is all too often simply lacking. Further, the possibility that a major part of potential Russian exporters actually are value subtractors (McKinnon, 1991) must clearly be taken seriously. In such cases, no devaluation would be sufficient to make exports competitive. Finally but not least, it may be that actual trade and domestic liberalization has simply not been sufficient to generate a supply response. It may also be that trade liberalization is too recent and the level of uncertainty too high for export behaviour to have changed.

4 Russian foreign trade rules in 1993

4.1 Maintaining the single exchange rate

The adoption of the single exchange rate principle can be regarded as a major achievement of the Yeltsin – Gaidar administration in 1992. This principle has been maintained in the face of continued criticisms fuelled by the collapse of the nominal rouble exchange rate. Two important factors help us understand how this has been possible.

First, the low external value of the rouble has not lead to the takeover of Russian assets by foreign investors, as foreign interest in investing in Russia has remained meagre for well-known reasons. Also, in the important test cases of the energy sector the government has staunchly protected the position of Russian investors – mainly the military-industrial sector – so that potential outsiders have felt themselves victimized by administrative discrimination.

Second, the above-described handling of centralized imports has implied the actual maintenance of a multiple exchange rate system for imports. The authorities have neutralized the impact of the nominally collapsing currency upon import costs by using foreign financing to buy the centralised imports while reselling these goods to domestic users at a highly concessionary price.

Abolishing import subsidies in 1993 is perhaps the most important foreign trade reform measure that has been taken since the reform process stalled in mid-1992. This was made possible by the rouble's strong appreciation in real terms in the second half of 1993. This development – together with the achievement of positive real interest rates in December 1993, which finally created a domestic asset for financial investment – also tended to check capital flight. Indeed, partly because Russian banks offered pre-risk interest rates of up to 36 per cent yearly on foreign currency deposits, the Central Bank of Russia has estimated that during the latter half of 1993 there may have been an illegal capital inflow of about USD 5–7 bill[27].

4.2 Continued export licensing

January 1993 brought a major change in export licensing and quotas. In principle, exports to former USSR countries and to other countries were now managed in the same way. This is a major step towards simplicity and transparency. Contrary to earlier intentions of liberalizing exports, there still remained 17 groups of goods subject to export quotas. As before, most Russian exports were subject to quotas in 1993, though there was some pruning of the list of items subject to quota

[27] Sergey Alexashenko, Rossiiskaya gazeta 27 April 1994.

during the year[28]. In principle, the quotas were determined by the Ministry of Economy, but in practice there may have been some 10 ministries handing out quotas[29]. Not surprisingly, Vice President Rutskoy made allegations of corruption in foreign trade a central part of his pre-referendum campaign of Spring 1993.

Furthermore, in January 1993 a partial re-centralization of exports took place. The government again engaged itself directly in export operations to be able to finance centralized imports and service the debt. The share of centralized exports was expected to increase to one-fourth. In the crucial cases of crude oil and natural gas, centralized exports were expected to amount to at least one half of total exports. Imports, on the other hand, remained almost totally liberalized. Tariffs were again readjusted, and this clearly tended to increase variability in the tax structure. Frequent tariff adjustments as such naturally create uncertainty in the economy.

Since January 1993, Russian imports have also been subject to the VAT. This may have depressed import levels.

4.3 A drift towards populism?

Interesting things began to happen regarding Russian foreign trade rules in the run-up to the parliamentary elections of December 1993. The government took drastic steps to protect Russian banks against foreign competition. It also announced that the use of foreign currency in cash transactions would be banned on 1 January 1994. The government also raised the import tax on cars and tobacco up to 35–55 and 100 per cent, respectively. Some of the leading reformist ministers also promised to impose prohibitive import taxes on imported food and clothing as well. All of these measures were expected to attract popular support among key political constituencies.

On the other hand the government felt strong enough to attack the numerous foreign trade privileges of different regions (see Sutela, 1994). However, this line was not followed consistently even up to the elections. Sakha, whose leader had supported the government in October, had its privileges reconfirmed.

The government also took steps to gain more effective control over capital flight. In August, the number of enterprises dealing with the export of licensed goods was curtailed. If implementable, such a decision should notably simplify export controls. In mid-October the central bank instituted new regulations on export-related payments. They came into effect on 1 January, 1994 for licensed exports, and on 1 March 1994 for other commodities. These regulations provide a three-stage control system involving commercial banks, customs and the central bank. The main responsibility rests with the commercial bank servicing the exporter.

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[28] During January-November 1993, the following items were removed from the quota list: ammonia, synthetic rubber, potash fertlizers, ammonium sulphate, unrectified methanol, calcium phosphates, wood and certain types of non-ferrous metals.

[29] V. Sokolov, Rossiiskaya gazeta 29 April 1993.

The proper conduct of foreign trade and payments remained a highly contested political issue also in 1993. Calls for increased state intervention – in particular concerning rates of exchange – remained vocal. Within the government a line seemed to be drawn between the few liberal ministers and the increasingly ardent supporters of industrial support and intervention, in particular in the Ministries of the Economy and Foreign Economic Relations. The issues of foreign trade corruption and 'selling of the Fatherland' figured prominently in the political debate. In terms of practical policies, there was clearly a drift towards increasing state intervention. This, however, changed in October 1993. For a short period, the government had a relatively free hand to pursue policies of its own liking. The result was visible in the decisions mentioned above.

In November 1993 the government also announced foreign trade rules that were to be in force beginning in January 1994. The abolishing of import subsidies, discussed above, was part of this package, which also included a pruning of quantitative export restrictions together with increased import duties. The raising of import duties, which was postponed for practical reasons until March 1994, included items like furniture, clothing, textiles and several foodstuffs. New duties were also introduced on some previously duty-free items like children's clothing, and the excise taxes on imported luxury goods were raised.

Russia formally applied for membership in GATT in June 1993. It was widely felt that the ongoing upward adjustment of import duties reflected not only growing calls for protectionism, but also tactical considerations: "Companies should expect the Russian government to raise import duties (despite its protestations to the contrary) as high as possible before accession to GATT, which is widely predicted to occur in the net 12–15 months"[30]. This, indeed, was confirmed during the months that followed.

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[30] Business Eastern Europe, 24 January 1994.

5 Year 1994

5.1 The plans

Much to the surprise of many observers, the refashioned Chernomyrdin Government of 1994 vowed to continue the policies actually presided over by the 1993 Chernomyrdin Government. In its policy Statement of 8 April 1994 ("Statement", 1994) the Government, specifically promised to continue the policy of a single, market-based exchange rate and that the CBR would refrain from "artificial" attempts at **de facto** pegging of the exchange rate and, what is more, to cut down the list of commodities subject to export quota to include only crude oil, diesel fuel, natural gas, electric energy, nickel, copper and aluminium, as from May 1994. Relative to the situation prevailing since the beginning of 1994, this should mean the liberalization of exports of such commodities as cellulose, soya beans, fish, durum and soft wheat[31]. All export quotas should be eliminated already by the end of 1994[32]. Export duties are also to be lowered, and the centralized export scheme should be eliminated at the beginning of 1995. Concerning imports, the government promises to limit centralized imports to a few commodities, and promises that none of the import subsidies eliminated as of 1 January 1994, will be reintroduced. Import duties should be non-protectionist, and their overall level will be moderate, with a clear declining trend.

Many of these promises are similar to the ones broken before. Moreover, they are not wholly consistent with the recent actions mentioned above. Therefore, even if the foreign trade sector must welcome government intention, uncertainty concerning their implementation will remain. As real appreciation of the rouble was stopped in 1994, there is also much uncertainty concerning competitiveness over the medium term.

An approximate doubling of the level of import duties was planned for 15 March 1994. The weighted average import duty, which has been about 8 per cent, was to rise to some 12 to 14 per cent[33]. The duty structure was also to become much more diversified than before, and some final products are to be given relatively high effective protection. This measure is another symptom of the growing protectionism, and this motive is openly admitted[34]. At the same time, new duties may be seen as negotiating chips for the medium term.

[31] If the list in the policy Statement is comprehensive, among the liberalized commodities would also be some oil products, certain hydrocarbons, hydrocarbon raw materials, some non-ferrous metals, ethyl alcohol, caviar, rough lumber, rail sleepers, wild animals and other somewhat exotic items. It is improbable that items like weapons, nuclear materials and narcotics would be liberalized. They have been subject to licenzes, but not to quotas.

[32] This tight schedule was one of the surprises of the Statement, as only a month earlier Russia had circulated information that export licensing and quotas are to be phased out by 1 January 1996.

[33] According to early information. The 8 April Statement states that the weighted average of import duties will not exceed 15 per cent in 1994.

[34] MVES as cited in Segodnya 20 April 1994.

Finally, the government decided on 14 April[35] to postpone the introduction of increased duties until 1 July 1994. Some of proposed changes may still be reconsidered[36]. Again, none of this increases credibility among traders as to the stability of trade rules.

Overall, a thorough overhaul of Russia's approach to foreign trade might be in the works. If in 1992–1993 the accent was on constraining exports through quantitative restrictions and export tariffs while at the same time pursuing import liberalization and even subsidising imports, the wheel has clearly turned full circle. The emphasis is now on protectionist import restrictions and export liberalization. It is too early to speculate whether this reversal will prove to be a permanent one. Promises about export liberalization have been broken so often that their credibility has been seriously impaired. The relative stabilization of the Russian economy, visible since late 1993, should open the road for more stable and market-economy compatible rules of the game. It was announced in late May 1994[37] that all export quotas and licences for oil and gas would be scrapped on 1 July. This finally signals the liberalization of most Russian exports, even though export taxes are to remain high.

5.2 Foreign trade Russian style, early 1994

The discussion above has emphasized the amount of political, administrative and economic uncertainty that has surrounded Russian foreign trade since late 1991. The general movement towards liberalization has not been reversed, but the process has been stop-and-go. Seldom has policy uncertainty been greater than in early 1994. This uncertainty continues, although recent announcements have been most encouraging. From the enterprise point of view, such uncertainty amounts to extra costs in starting and continuing foreign trade activities. Some examples should clarify the situation.

In early 1994, 70 per cent of Russian imports and 75 per cent of exports, in value terms, are subject to duties. Duties are subject to frequent revision, their diversity tends to increase, and the general level of import duties is rising at the same time as the list of items whose export is subject to quantitative restriction tends to shorten. Promises concerning export liberalization however, have been repeatedly broken. Announced dates of duty revision have recently been repeatedly shifted forward. It is symptomatic of the situation that according to press reports the government now – after much criticism – contemplates promising that in the future such revisions would be announced at least 90 days beforehand to give traders time for adjustment[38].

Traders of items subject to duties thus face uncertainty as to both the level of duties and the relevance of announcements of policy change. In cases were such

[35] See Rossiiskie vesti 16 April 1994.

[36] Aleksandr Shokhin in Segodnya 14 April 1994.

[37] See Financial Times 24 May 1994.

[38] Rossiiskie vesti 16 April 1994.

uncertainty concerns sufficiently great values, traders can only protect themselves by going underground, that is through smuggling, underreporting and related techniques.

In early 1994 export licences and quotas still applied to the bulk of Russian exports. The global export quota for goods is set by the Ministry of Economics, with the agreement of other concerned ministries and offices. Global quotas are based on forecasts of supply and demand for the goods subject to licensing. The granting of licences is characterized as a composite procedure including both administrative and economic allocation. In practice, administrative criteria clearly predominate. Thus, for 1994 quotas for the export of only 5000 tons of copper and 10000 tons of nickel were auctioned[39].

An enterprise interested in a quota can thus use the normal administrative methods of influence, old-boy networks and bribing. If that proves impossible, smuggling is a possibility. For a potential new exporter, one possibility might be appealing to regional authorities to see if they are willing to try and circumvent federal jurisdiction.

Other sources of continuing uncertainty include the reorganization of foreign trade activities, as in armaments trade[40]. The Central Bank of Russia has also proposed what seems to be a new set of currency regulations. According to reports[41] these regulations mention criminal punishment for "foreign exchange offences".

Still, one should emphasise that even if words like "chaotic" and "collapse" are often used in discussing Russian foreign trade, Russian enterprises have been able to adjust. The fact that even statistically recorded Russian exports have turned upward while the decline in imports must be heavily exaggerated, is proof of an ongoing adjustment.

Two theories compete concerning the adjustment of Russian enterprises. On one account, those badly hit are forced into adjustment. Others argue that those in the best position to adjust will also be able to do it. Clarke and others (1994), who adhere to the second viewpoint, describe the export adjustment strategies of one enterprise which has been very successful in getting export licences. They conclude: "Science knows its proper limits – suffice it to say that the director has been spectacularly successful in exercising the traditional lobbying skills of the Soviet director" (op.cit., p. 193).

Exercising the traditional skills of a Soviet manager is however not the only way of adapting for survival. There are case studies of enterprises adapting through export expansion, though "this is only an option for a few" (Boeva and Dolgopiatova, 1994, p. 118). The problems cited include unprofitability of exports, low competitiveness due to the existing technological level and the lack of market contacts and expertise.

Denis Kiselyov (1993) cites an empirical survey which tends to confirm the qualitative conclusions reached above. He emphasizes the importance of limited access to OECD markets, but also the fact that some exporters, especially of metals, have been very successful in aggressively penetrating markets. Other

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[39] Reuters, 25 March 1994.

[40] Izvestiya 19 February, Reuters 25 March 1994.

[41] Reuters, 20 April 1994.

factors underscored are the relatively high start-up costs, especially for traditional home market producers, the uncertainties of Russian infrastructure, and the costs involved in currency surrender requirements.

6 Some issues and controversies in Russian foreign trade reform

6.1 The relations between domestic reform and the foreign sector

In the literature on Soviet economic reforms, the closed nature of the economy was early diagnosed as one of those pillars of the traditional regime that deserved to be transformed (see, for instance, Hough, 1988). As the agenda shifted from reform to systemic transformation, liberalization of foreign trade and payments became a central part of the orthodox prescription of stabilization, liberalization, privatization and restructuring. Opening the economy to foreign trade introduces rational prices, exposes domestic producers to foreign competition and enhances technical progress, though it was doubted even in the Washington mainstream that a rapid move to world prices would be the right strategy for a large, closed economy such as the USSR (Fischer – Gelb, 1991), especially note 29).

Widely shared though this orthodoxy became, there were always doubters, especially as regards a Polish-type of immediate or very early sequencing of trade liberalization and current account convertibility (see, for instance, Nuti, 1991). However, it is now admitted that the Polish experience shows that – for that country at least – immediate foreign liberalization and current account convertibility was feasible. Still, the critics hold, free trade also destroys such activities which, though unprofitable at world prices, still contribute to national income, employment, exports and consumption (Nuti, 1992; see also Gomulka, 1992). Thus, according to this view, gradualism in convertibility and trade opening is not necessarily unfounded up to the point where some progress is made in capacity restructuring (see also McKinnon, 1991). Hungary can be cited as an assumed gradualist – though in the foreign trade sector Hungarian reforms have actually been relatively fast – that has succeeded in maintaining reform impetus. This aspect of the transition may well be the only major one were both shock therapies and gradualism can be backed up with rational economic arguments.

The Yeltsin administration worked under great pressure in late 1991. The Soviet Union and its centralized administration collapsed somewhat unexpectedly and the economy deteriorated rapidly, resulting in near hyperinflation, plunging production and a total drying up of currency reserves. No one was in a position to control prices and certain other economic activities, and having only partial legitimacy, the Government clearly felt it had to act quickly. There was no alternative to rapid liberalization and attempted stabilization, even if it was obvious from the very beginning that success would be at best partial, given the existing state of institutions and policy instruments.

Views concerning trade liberalization and convertibility did differ, however. Following the Polish model, influential outside advisors had recommended that the rouble should be made convertible and trade liberalized "as soon as possible, either simultaneously with or very quickly after most prices are liberalised"[42].

[42] The Soviet..., 1991, p. 16.

This was not, however, the route chosen. As chronicled by a Polish advisor to the Russian government, the Russian path was formulated over a number of steps (see Dabrowski, 1993). The first draft economic programme of the Russian government proposed gradual liberalization and stabilization over a period of one year. After initial liberalization of prices and partial liberalization of the foreign sector, a currency reform would take place after 8–9 months. A new Russian currency would be introduced, convertible into hard currencies. The latter theme figured in many of Yeltsin's speeches in late 1991.

This approach met with much criticism from the foreign advisors of the government. They would have preferred a single complex shock operation, including the immediate introduction of current account convertibility (Dabrowski, 1993). As pointed out above, there actually were governmental pronouncements on introducing convertibility together with the first phase of the reform at the beginning of January 1992. This did not take place, perhaps also because Russia, not being a member of the Bretton Woods institutions, could not at that time receive foreign support for convertibility. Contrary to the wishes of the advisors, the Russian government stuck to its original phased approach, only abandoning the currency reform idea.

This implied that the Russian government had in fact opted for a phased, even gradualist, reform strategy in preference to an overall shock therapy. It is unclear what the merits of gradualism in the Russian case might be. A politically weak government, surrounded by a disintegrating bureaucracy largely hostile to market reform, facing economic collapse and a population at best indifferent, and trying to implement policies without many of the appropriate instruments at its disposal, would surely seem to be lacking the necessary preconditions for social engineering. In practice, the implementation of economic policies tended to turn sequencing into muddling through (Nuti – Pisani-Ferry, 1992; Åslund, 1993). The Government, which was originally proud of not having a written programme, soon became entangled in a true orgy of policy improvisation. This has been demonstrated above in some detail. In the autumn of 1992 the situation deteriorated further. Government policies started drifting, and the eager reformers of early 1992 now had to negotiate a compromise with the vested interests of the industrial lobby from a position of weakness.

6.2 At the crossroads: westernizers and eurasians reborn

We may now be witnessing another shift in official Russian economic thinking, this time from the liberalism of the early Gaidar team towards government-led development policies. This tendency has been much strengthened by the search for compromise with the industrial lobby, but it was already visible in the earlier programmatic statements of foreign trade officials detailed above. The foreign sector might have acted as a pioneer of liberalization. In fact, by summer 1992 the Russian government was already reintroducing trade controls. The Yeltsin degree – though having no practical impact – forbidding domestic retrading as speculation[43] came several months later. It also seems that, such decrees had more practical importance in the foreign trade sector than in domestic affairs.

In Russia, much debate on the foreign sector has centred around the "strawman" themes of Western-style foreign sector liberalization and Far Eastern-style strong governments. Naturally, such debates have many facets. There is much extremely vague and badly focused general discussion on alleged and real Russian peculiarities, but several problems with more concrete ramifications have also come up for discussion.

First, there is the issue of the appropriate geographical distribution of trade. Foreign Trade Minister **Aven** shared with others the somewhat peculiar view that Russian exporters should try to conquer not so much the difficult Western European markets as those of Africa and Latin America[44]. Second, but related, is the issue of export composition, in particular of the advisability of arms export. This may be one of the few areas in which Russia is competitive, but at the same time an area where conflicts with the G7 countries could easily arise. The administration has reportedly been divided on this issue. In practice, Russian entities have recently pushed aggressively for arms exports.

Third, there is the issue of economic self-reliance. Thus, the then first vice-premier **Shumeyko** has argued[45], noting the negligible flow of foreign investment into Russia, that the Japanese road of self-sufficient industrial development would also be the appropriate path for Russia. Having seemingly really believed that Russia would receive hugh sums of direct foreign assistance in the form of money, the Russian government as a whole seemed to have adjusted itself to regarding reliance on domestic resources as, if not a goal, at least a fact of life. And naturally, both Shumeyko and others, including economists from the Far East, have argued that the standard IMF programmes would be inappropriate for Russia due to its (usually unspecified) peculiarities. Academician **Petrakov**, who decades ago used to be the most prominent proponent of a market-based economy among Russian economists, was something of a pioneer by being more explicit in his opposition to the IMF than most early Russian commentators (Petrakov, 1992). To him the case seemed to boil down to Russian pride. Not a single developed country, he wrote in mid-1992, has been subjected to the IMF remedies. Though Russia is backward in consumption, to Petrakov and many others it remains a superpower in productive structure. Therefore the "Chilean-Mexican-Polish path" is not the road to a better Russia.

Petrakov's views – also repeated in (Shatalin et al), 1994 – pale in comparison with some other noted comments following the December 1993 elections. Thus Gavriil Popov (1994) is now convinced that the whole programme of Westernizing reformers was supported by "the West" only because it was seen as a means of abolishing Russia as a potential military adversary and economic competitor. "The West" has been intent on destroying Russia, and the reformers have been willing agents in the devilish plot.

Of course, the "Washington consensus" in development policies is not beyond criticism. Alternative approaches in development economics may well have greater

[43] Kommersant 1 November 1992.

[44] Pravitelstvennyi vestnik 1992:1.

[45] See BBC SWB SU/1467 C/3-4.

academic respectability than allowed for by the mainstream, the IMF record in developing countries is less than perfect, and the East Asian growth experience has led some of those countries to be openly critical towards the consensus, in particular concerning the standard requirement for trade liberalization (The Overseas..., 1991). Knowledgeable experts have drawn attention to the East Asian lessons that might be relevant for Russia and other countries in transition (Katz, 1991; Fry – Nuti, 1992). Even though the "Washington consensus" is based on the "monoeconomics" view that economic laws are the same everywhere, few would seriously argue with the proposition that in designing policies one should take into account the history, culture, institutions, economic preconditions and politics of the country involved.

Disagreements begin when one gets down to what accounting for such peculiarities really means. The most disappointing fact about Russian debates – at least as published – is that there is much noise but hardly any cogent and rational argumentation this issue. Indeed, given the current lack of consensus on development goals due to the crucial Russian peculiarities, the deterioration of the central administrative authorities, the haphazard policies, the probably very widespread corruption and the **de facto** regional devolution of decision making powers, one may perhaps be excused for wondering how any honest observer could possibly reach the conclusion that Far Eastern type **dirigisme** might be either feasible or desirable in Russia. Neither is it quite clear what is meant in arguing that even if Russia – due to its peculiarities – cannot take any of the roads already travelled the Russian model would be applicable to both the former Soviet republics and to several Eastern European countries (Popov, 1994).

7 Concluding remarks

The failure of recent Russian economic policies must be regarded as evident in respect to foreign sector liberalization. The road selected in November 1991 led to the collapse of trade volumes, a serious depreciation of the rouble and to partial reinstitution of foreign trade controls. We do not know what the adoption of a more consistently liberal overall reform strategy would have led to. Neither can we tell for sure whether the current failure was inevitable, given the starting conditions in the autumn of 1991, or whether it could have been avoided, given better policies, more experienced policy-makers and more foreign assistance. Still, no clear reorientation of Russian foreign trade policies is under way, and it is probable that the principle of a single market-determined rate of exchange rate will not be abandoned as a goal. It is difficult to believe that a return to the old days of state monopoly of foreign trade might even be seriously contemplated.

There is a possible negative turn of events which is more likely than an outright reversal of reform policies. What we may instead witness in the near future is another instance of the traditional Russian Chasm between far-reaching government goals and available resources. Over the last centuries, Russian governments have over-reached themselves, more often than not in an attempt to implement the messianistic plans of the intelligentsia. The Russian state has become swollen, but more in its goals than in its resources. Over-reaching has typically ended in impotency.

This, surely, was the fate of many of the czars and of Lenin, and in a way it was also Stalin's final fate. Gorbachev's efforts collapsed, and Yeltsin may be well on the same path. By borrowing a social base from the vested interests the current administration may be able to get a new lease of life. Still, the fundamental fact of continuing deterioration of central power remains. In the midst of rent-seeking, inside dealing and corruption, the government has been playing with plans for industrial policies, centrally directed privatization and – indeed – foreign trade controls.

If recent policy statements are to be believed, the government has however abandoned the idea of a full-scale reconstitution of trade controls. Indeed, as has been emphasized above, the trend towards trade liberalization is officially set to continue. Though the picture is far from being clear, it is obvious that the authorities have by now learned to respect the boundary between what is feasible and what is not, to a greater extent than before.

Still, outright liberalism – the abandonment of attempts at central control – will not be part of the solution. Any Moscow government will rightly defend the unity of Russia, and that implies at least the maintenance of a common currency area as well as a large degree of common rules of the economic game, the foreign sector included. The only available path seems to be more of the same as now, muddling through or – if you like – the uncivil society. As 1993 has shown, much depends on the macroeconomic environment. There, as before, three indicators are to be watched closely: the amount of subsidisation in the economy, the relations between the centre and the regions, and the relations between Russian and the other FSU republics.

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