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Building Russia's Creative Capital**

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Moderator:

Gregory L. White, Chief, Wall Street Journal-Dow Jones Newswires joint
Moscow Bureau

Panelists:

Yaroslav Kuzminov, Head of the Expert Group of the 'Strategy 2020' Project,
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Vladimir Mau, Head of the Expert Group of the 'Strategy 2020' Project, Rector,
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G. White:

Good afternoon everyone. Welcome to the Strategy 2020 conference. My name is Gregory White. I am the Editor in Chief of the Wall Street Journal in Russia. It is with great pleasure that I welcome you here. This topic will be discussed by the coordinators of this project: Yaroslav Kuzminov, Rector of the Higher School of Economics and Vladimir Mau, Rector of the Russian Presidential Academy of National Economy and Public Administration. The format will be relatively free: first we will hear short introductions from our speakers, then we will take questions and discussion. We will work until 13:15. Who would like to speak first?

V. Mau:

Dear colleagues, the context of our work is familiar enough to those present here, so I will not spend too long on details. But the formulation of the tasks we have been set is connected to the imperative outlining of new or renewed economic policy for the next decade. In my understanding, it is connected with the fact that the economic model of the past ten years has, to a great extent, been based on the experience of 1998, the economic crisis of 1998 and the climb out of it. It was a model tied to reconstructive growth, in other words, growth that was based on the use of new capacities, rather than on investment. This growth was based on stabilization and the influx of windfall money. It was growth in which the national currency was not allowed to become stronger, as it was considered, and correctly considered, that its low exchange rate would allow for the development of internal production and discourage import. It was a model based on expensive internal credit markets and cheap overseas credit resources, which allowed for the quick growth of credit activity in overseas banks. It was a model of growth for the public sector, of nationalization which was seen as an aspect of stabilization. In our opinion, this system has more or

less exhausted its usefulness, and we have turned to the formulation of a new model for growth.

I should add to this that the global economic crisis of 2008-2009 has also demonstrated new realities. We are not going to begin a discussion about whether or not the crisis has ended, or about which phase of the crisis we have reached. But the events of 2008-2009 have equally posed the problems of a new paradigm for growth on a global scale, of the model for regulation itself, of the new balance of currencies, of the prospects for reserve currency, and the role of regional reserve currency. This is everything that has begun to be called the "new normal" in the United States, but which we call the "new model for economic growth".

What, in my view, are the lessons we should learn from this, what are the challenges and guidelines for economic policy, what problems need to be discussed? What should be placed at the foundation of future economic development? We are talking about the next decade, effectively about a new stage in economic development. Above all, the problem is one of macroeconomic stability. We often talk about this as if Carthage must be destroyed. But even so, what many, in my opinion, have not fully realised, is that in the new state of affairs, we again find ourselves with a budget deficit from a macroeconomic perspective. This is a radically new situation, to which we have grown unaccustomed over the past ten years. Until now we have discussed economic policy without thinking about a budget deficit.

Incidentally, I would even say that the problem is more serious, as the macroeconomic situation is very similar to that which arose between 1979 and 1981. The value of crude oil in the current market is the same as it was then, and that was at its peak. Budget calculations leave us with a small deficit, and our macroeconomic position is ostensibly better than that of most other Western countries; but at the same time, the economy is extremely volatile, because the deficit is calculated from current oil prices, without the formation of reserves,

without the formation of a stabilization fund. We are, just like at the beginning of the 80s, in a situation of ostensibly good macroeconomic indicators, but with a sharply increased risk of macroeconomic imbalance. And if we do not change the economic model, we can expect either an extreme increase in debt; or hope and pray that the price of oil will stay at the level of 200 USD per barrel over the next ten years. If it does, then the budget would add up for all the commitments we have made. Of course this is very dangerous.

The second set of questions is connected to monetary policy. In my understanding, we should not prevent the rouble from strengthening simply because a low exchange rate was a significant factor in supporting internal competitiveness when the rouble was 20-30% from parity with purchasing power. At 50-60% or higher, there is really no sense in it. The events of the past years and attempts to stimulate demand through the budget and through social programmes have shown, by our reckoning – more precisely, by the reckoning of the Gaidar Institute – that around 70% of the rise in demand in these circumstances goes either to import or to inflation. Thus, at the given level of parity with purchasing power, the control of exchange rate does not lead to the discouragement of Chinese import, or of cheap import from the east more generally. We can no longer compensate for the problem of low competitiveness through the manipulation of the exchange rate. We are not discussing three-fold devaluation here, which would be absurd, impossible, and politically and economically senseless.

We must admit that the battle against the strengthening of exchange rate at the expense of inflation has exhausted its potential. The alternative is to reduce inflation and agree to the strengthening of exchange rate. The suppression of inflation must bring with it lowered interest rates, which means the replacement of external money and external loans which make corporations and the financial sector inward looking. It is clear that without the reduction of inflation and the lowering of interest rates, the two tasks which one way or another lie ahead of

us on the international plane cannot be resolved: these are the prospects of the rouble as a regional reserve currency, without which it simply will not have any prospects, and the prospects of Russia as an international financial centre, which the President has spoken about. Without the resolution of these monetary problems, these questions cannot be solved.

Another problem which cannot be ignored is that of the stabilization fund. A few years ago, it seemed that we had found a solution to the problem of cheap money, that we had found a way out of the 'Dutch disease', putting windfall money into the stabilization fund. The crisis has shown that on a macroeconomic level, this more-or-less solved the problem, but structurally, the stabilization fund has turned out to be a factor in counteracting modernization. Yaroslav Kuzminov and I, in our winter letter to the President, wrote that the crisis did not act as a fire break, precisely because the stabilization fund did not allow it to. Having large reserves has allowed us to smooth over the problem, neglecting structural modernization. The thing is, structural modernization always means social problems, always means a rise in unemployment. I do not know how best to escape from this trap, but clearly we cannot decline to form a stabilization fund, and to balance the budget according to the average price of oil over many years, and move windfall money into the stabilization fund. But at the same time, we understand that the stabilization fund is becoming an obstacle on the path to modernization, in as much as it allows us to solve problems without modernization, at least in the short term.

From this, the following problem arises: the problem of competitiveness, yet another strategic problem which has appeared in recent years. The situation is without precedent: Russia is a country with expensive labour and bad institutions. What is the problem with the Russian investment climate? The investment climate is good when institutions are bad but labour is cheap, or when labour is expensive but institutions are good. In our case, with expensive labour and bad institutions, the situation is extremely unpleasant and, in fact,

generates the problem of the investment climate. We must, instead of crying out "How can we attract investors?", think about what we will attract them with: institutions or labour. The resolution of this problem is also one of our most important tasks. It is possible to console ourselves with the conclusion that Russia is a country of services and raw materials, of non-tradable resources; but we understand that real modernization demands tradables.

Modernization occurs in those countries where the production of goods, and industry in the broad sense, play a fundamental role in the economy; where there are whole industrial sectors. We need goods; not construction, not tourism and not resources. And thus the pitfall of competitiveness becomes yet another of our most important tasks. Without competition, all discussion about how to better the quality of institutions becomes empty words. We believe that, from the experience of our work, one of the lessons to be learned from successful modernizing countries is an ability, when improving institutions, not to try on all fronts, saying that we will solve everything, but to make targeted improvements of institutions. At least, all successful cases over the past 50 years have been characterized precisely by this. To put it crudely, we must look at those international markets in which Russia appears worst of all, and concentrate on these points; we must not say that all institutions must be improved in all aspects.

It seems to me, that from this we can draw a conclusion relating to industrial policy. We have argued for 20 years over whether or not we need an industrial policy. I have even said at some point that the best industrial policy is its absence. Generally speaking, this is not entirely the case. The best industrial policy is a policy stimulating competition. I would like to underline precisely the stimulation of competition, as opposed to the struggle against monopolies. We understand that there is a monopolistic agenda; but we also understand that the basic stimulus of an innovative economy, if we are not talking about natural monopolies, is the drive of entrepreneurs to become monopolists. From this

perspective, an antimonopolistic policy is too populist a battle cry, and cannot be at all certain to ensure competition. The monopoly can be replaced by the government controlling it, which is also a monopoly. From this perspective, industrial policy as a special programme ensuring competition is undoubtedly a most important priority.

Another question I would like to draw your attention to is the problem of capital flight. The outflow of capital which we have recently discussed – this is, of course, the departure of the elite – is very dangerous. It is a most complicated problem. In a globalized world, when the costs of travel and of the movement of capital are very low, and almost everyone can speak a foreign language, this threat becomes fundamental. Yaroslav Kuzminov will probably talk about education and health insurance. I cannot see any means of keeping the elite here, other than ensuring better conditions of education and health insurance for them. It is for this reason that particularly safe conditions for capital or the reduction of taxes are unnecessary: it is always possible to find a safe haven. The main way of holding onto the elite lies in our ability to ensure health insurance and education in the country. The elite is currently leaving for places where there are better living conditions. And this is of fundamental importance.

It is possible to name several other factors, I will stop here. I would simply like to say that all in all, this is a move from the economics of demand to the economics of supply, to the economics of stimulation of entrepreneurial activity; not on account of state or private demand, but on account of supply. It is substantially the same task which was undertaken by Western governments on the cusp of the 70s and 80s. We are returning again to the 70s and the 80s, but what indeed were Reaganomics and Thatcherism if not a move from Keynesian economics of demand to the economics of supply? In short, this is precisely the task which lies ahead of us. Thank you.

G. White:

Thank you, Vladimir, for such a detailed analysis of the problem. It seems, of course, rather gloomy.

V. Mau:

I think it is actually very optimistic.

G. White:

Let us now turn to the question of what is to be done, which Yaroslav will outline for us.

Y. Kuzminov:

Good afternoon, colleagues. As Vladimir has not said anything about it, I shall quickly say something about the scope of our work. You have here a presentation which was made for the government a few months ago. 21 expert groups were organized. The leaders of a number of expert groups are present here, who are qualified for the analysis of the situation. Alexander Galushko – tax policy; Isaac Frumin – socialization, secondary education; Sergei Sinelnikov – budget policy; Professor Spartak should be here somewhere – that's integration; Academician Dymkin, he's managed to squeeze into a corner there – that's the place of Russia in the global division of labour. Professor Jakobson has already left. Our colleagues are sufficiently well known to you, so we can take part in discussion and answer your questions.

I feel bound to say, our task is not to completely rewrite strategy. The strategy should be more or less homogeneous. Our task is to present possible variations of policy within concrete sectors – for example the health insurance sector, the sector for tax policy, the sector for macroeconomic balancing of the economy – and weigh up very carefully the budget consequences of this policy for economic growth, basic social reactions to this policy, and the basic reactions of elite groups to this policy. First of all we gathered together a large number of experts.

Now almost 2,000 experts are currently working in these expert groups, contributing materials and their evaluations of these materials. Many regional experts have been drawn into this work and, of course, we are now, one way or another, beginning to outline various policies and possible variations.

But there are also inadmissible variations which we have from the very beginning outlined to the Prime Minister. He has agreed that there are areas of admissibility, and agreed with our evaluation of these zones of admissible policy. I often talk with Vladimir about what is inadmissible policy. Inadmissible policy is the descent into inflationary financing of budget obligations, whatever they are caused by. It is at this point that policy descends into demagogy. One or another opposition forces may announce that we can, that we must spend 7% of GDP from the budget on education; another 5%, or better, 6% on science; another 8% on health insurance without under any circumstances withholding support to those sectors which are traditionally well developed here. We have calculated that what is being suggested by the left end of the political spectrum, and completely officially in its programmes, comes to 80% of GDP altogether, instead of the 38% of expenditure already raised by the government which we have now.

It is perfectly obvious that there are two possible outcomes to this. The first, completely possible outcome is the rise of communism, and military communism at that, because nothing like this kind of centralization, bringing everything to the centre and distributing from the centre, has been seen since 1919, in my opinion. Theoretically this is possible. The second is a descent into inflation: if we allocate 7% of GDP to education, and to other sectors, instead of the 4.5% hitherto allocated, the result would be a 3–3.5% rise in inflation. We have also been through this in the 90s.

There is another limitation, another 'red zone': this is the encroachment into the established amount of social support for those in need in Russia. Only 25% of the Russian population today belongs to the middle class. Maintaining social

stability without being a social state is simply not possible. Russia is a social state, our policy to an enormous extent is social policy: support for the poor, the reduction of poverty, which goes beyond the normal scope. At the moment we officially have about 15% of people classified as poor, which of course needs to be reduced to zero. To this end, reference is often made to various projects as economically effective: let's reach a level of growth compared to China and India. Neither in China, nor in India is there such social protection of the population, such a high level of free health insurance and education, such a solid pensions system for every individual, which protects him from poverty. We simply cannot use these models, neither the Chinese nor the Indian, and any discussions of the possibility of these models are purely academic discussions between economists, which I hope will not be admitted to the formulation of actual policy.

Vladimir has spoken about the macroeconomic evaluation of the situation. I will say something of the several, central conclusions we have drawn between groups, in relation to important sectors of economic policy. First of all is social policy. Russia now has a colossal challenge ahead of it, the looming problem of higher education. Of those aged between 25 and 30, we have 57% in higher education. There are only four countries in the world with similar figures: Canada, Finland, Japan, and the fourth I have forgotten. Let us say that in the USA and France only 41% of people have higher education. This is a huge driver of growth and at the same time a huge risk: if we look at the population aged between 15 and 25, 85% will receive or intend to receive higher education. This does not exist in a single country in the world. This is a massive move away from manual labour, a move away from monotonous work, from work which does not have any elements of communication or creativity. It is really a huge challenge. We are far from thinking that it will be somehow be possible to return people to their original status and drive them into vocational schools: they are not going to go.

From this a number of consequences arise. Firstly, not only as a result of our demographic situation, but also because of the state of our developing labour market, we are bound to an active immigration policy, to active encouragement of immigration. This policy must be differentiated in relation to people with different levels of education; we must promote the entry of families, the permanent entry into Russian territory of people with a high level of education. And in contrast, those people who occupy positions of low qualified labour, must be allowed entry only on short term visas. It seems to me that here we must very clearly direct the public mood. Without migrant workers, Russia's economy cannot exist even now, and this tendency will grow stronger each year.

Secondly, this is a problem of the lifestyle orientation of the middle class, the lifestyle orientation of those who have received higher education. Understand that this includes not just people with degrees but also those who think of themselves as middle class. But these people are not categorised in the-present day 25%, nor are they in the 40% of the population which will make up the middle class of Russia by around 2020, according to an internal forecast. This is the key challenge! What does this mean? We must offer these people positive lifestyle strategies, positive education strategies, we must assist them in realising the level they wish to, and can, achieve.

I shall give a few examples. The first is the applied baccalaureate. Germany has already taken up a similar system: you enter university, but after two years of study you have the option to take a short module – eight months, ten months – for a specific qualification which offers concrete earning possibilities. And it is then possible to work with this qualification. At any moment you can return to your third year of study and continue your university education, you are psychologically still at university. You are not among the 15% who do not get into university, whom city employers are afraid of taking on. And most importantly, we will be allowing people with completely different horizons to enter into a whole range of professions requiring practical skills, from qualified

personnel to tradesmen. God knows what possibilities for growth this will give to Russia.

The second example is the social services situation. The new middle class, or the potential middle class, is a group of people with a completely different lifestyle orientation. Most people of older generations in principle will not accept any kind of social service unless it is totally free of charge, even when this means it is ineffective. People over 40 demand free health insurance, free education, the basic pension which is provided by the state and nothing more. But the lifestyle orientation of the younger generations, the educated generations, is completely different: they are prepared to pay for service of a higher quality.

Ahead of us lies the task of a reconstruction of social policy which would only improve over these ten years the quality of social services to those people who are oriented towards receiving them for free: this is a separate task. A pay-as-you-go pensions scheme should be developed, with pension payments increasing with time, and free health insurance and education should only be improved. I will say a little more about this in a moment. But alongside this, we must form a transparent system of contribution into health insurance for those who wish to take this route and a transparent cumulative pensions scheme, which people can trust, because the pay-as-you-go system is incapable of providing adequate pensions for any of the people sitting in this hall. None of us would be prepared to live on RUB 10,000 a month; that would be impossible! It is psychologically impossible for an active person who works now, and there is no other option for us than a cumulative pensions system. Consequently, we must think about how to make such a scheme stable, so that accumulated pension funds are not 'eaten up' in the long term, and so that people can trust this system. This is a direction for the potential expenditure of government money, whatever form that may take—whether the system is supported from the fund of national savings, or from somewhere else. We will potentially save

money in moving to a more effective pay-as-you-go pensions system. But it will be necessary to spend two thirds of this money on raising the stability of the cumulative system in the eyes of the people, who would be putting their money into pensions accounts. This cannot become a source of funds for other projects.

The question is often posed, how much money is needed for education, health insurance, culture etc.? I have spoken with Igor Jurgens about the need to propose a formula: the budgeted financing of these three sectors is 10% of GDP. There is in fact an absolutely realistic criterion suggested by our expert group: the so-called effective contract. We have sociological statistics about the kind of salaries people – teachers, professors, doctors – consider enough in order to work only in their main place of employment and not seek additional sources of income. For example, for schoolteachers this is the average salary in their region; for university lecturers it is around twice the average salary in the region; for doctors a little less than twice the average, somewhere between 150 and 170, with doctors there is strong differentiation between regions. These are absolutely concrete, calculable things.

As a result, we can say that if we do not restructure the social sphere, if we do not kill off ineffective enterprises, this will take a further 4% of GDP. If we combine this with a mature restructuring of the social sphere, which the government also can in no way undertake, it will take a further 2–2.5% of GDP. And this is a problem for the government. If it wants to leave everything untouched, the restoration of this sphere will end up being more expensive. If it is ready to tackle the ineffective elements of the social sector, undertake real reforms of the budget network, then it will work out twice as cheaply and become a realistic prospect for 2020. As you know, Putin has already announced that we are implementing the first stage, ensuring the salaries of secondary school teachers this year at the average level by region. This is the first step, and I am certain that more will follow.

I will quickly say something about three more things. An effective government. In our view, it requires three things: firstly, the limitation of risk for business from the perspective of the law, criminal risks. Medvedev's latest initiatives are indeed aimed in this direction. Secondly, the elimination of a large part of the supervisory activity of the government and its replacement by compulsory insurance. And thirdly, the considerable reduction of the army of people currently in the police force, who are today more than 3 million in number. This is around three times more than in any other country: it seems to me that this is a very significant possible tightening-up for the government.

Now I will say something about another aspect of our activity. I see that the leader of the expert group on infrastructure is present here. Not so long ago we had a publication in *Izvestiya*: a key factor for economic growth now is adequate investment in transport and other business infrastructure. It would be good if we could raise infrastructure to reach not a 20 km radius around large cities but a 50-60 km radius, like in the majority of developed countries. You would be able to travel there quickly, and there would be gas, electricity, and running water. We would solve, to a massive extent, the problem of access to resources for business, and, by the way, access to resources for building cheap housing, but it would cost around RUB 1 trillion per year. Where would we get that from? It is possible to count various ways of reducing expenditure. We are now discussing these. Thank you.

G. White:

We have received a clear enough picture of the situation. As I understand it, there is a whole list of reforms which must be incorporated in the strategy, although, obviously, questions of policy were deliberately put to one side at the beginning of this work. The first question is: how realistic is it to bring about all of these changes without political changes, political reform? Or is there an understanding that these changes will lead to changes in the political sphere?

Y. Kuzminov:

I think the basic problem with the political system in Russia is the need to restore effectiveness in autonomous agencies at the local level and professional associations. These are basic elements of civil society. If they begin to function, if the people within them learn to make rational choices, to vote rationally, to supervise things rationally, this will guarantee the larger political system will function adequately, resting on the rational decisions of voters. As long as this is not the case, any suggestion for the modification of the political system will not bring about the desired efficiency. We need to cultivate an effectively functioning system of local government over probably the next 10 -15 years, and this will require the transfer of taxation, and other elements of real authority, to the municipalities.

This is a very complicated task for Russia, as you can understand. There are very great regional differences and it would be impossible to simply say "Here you go, we are giving you the right to impose taxes". We must guarantee in Russia's conditions, transfers from the federal, and regional budgets; to guarantee them and not link them to any indicators. This is the eternal argument between the Ministry of Finance and sectoral departments, including with that part of the Higher School of Economics which studies governance. I fully support the position of the Ministry of Finance here. We must guarantee a definite slice of the budget goes automatically to the running of the institutions of local government, without any need for lobbying. Let them work not with the management, but with the people. That would be my answer. Vladimir, maybe you have a different one?

V. Mau:

No, I fully share the opinion that the development of the political system must now begin first of all at the municipal level. That is, in fact, what Yaroslav has

said: this is one of the fundamental theses of the group studying practicable federalism, as this group, having started studying practicable federalism, quickly moved to the problem of municipal development. And in their understanding it is precisely at this level that the seeds will be sown for the new political system. But even so, I, as an economist, believe that demand gives rise to supply. I do not believe in political reform without the demand for political reform, just as I do not believe in modernisation without the demand for modernisation. The problem is of developing the political system about the wish of the higher authorities to improve or worsen things, to do something. It is a problem of the political authorities' readiness to answer to the demand that arises in the main levels of society. This is something which always exists, in all countries, under all regimes. And only this kind of system can become stable.

G. White:

On the subject of the demand for modernization: usually, when we are talking about such decisions, about the division of budget resources, this demand arises in Russia in crisis situations, when the prices of oil and other exports are low, and there is no other option. In the current situation, with relatively high prices, which according to many forecasts will remain stable or grow higher in the years to come, where will this demand for modernization come from, and will it be enough to bring about not only changes for the better but also unhealthy ones?

V. Mau:

I didn't begin talking about this topic in my introductory speech because it would have made it too long. We are often asked to what extent we implement the reforms and policies we discuss. I am sure they are absolutely realisable, because it is the actual agenda the government will be following. The second question is whether this is a consequence of the crisis or for the avoidance of

crisis. The issue is only in this, there is only one agenda, which will be announced sooner or later. I am not a political prophet, and I cannot and will not try to say exactly when, as our professional duty is to present a set of interconnected elements of economic policy when the demand for it arises.

My personal opinion (and here I cannot speak for both of us, nor can I speak for any group, this is the position of an economic historian) is that in the economics of resources, reforms only occur when the income from those resources is exhausted; in the economics of investment, only when the income from these investments is exhausted. Indeed, what I have said about the stabilization fund and its destimulating role is in fact connected with this: if you have a lot of money, why would you be interested in economic policy? If everything is fine as it is? Of course, a responsible politician, and in the last 10 years we have formed responsible economic policy, understands that the price of oil will fall. Yegor Gaidar had two phrases about oil, many know them but I will repeat them. One went roughly like this: "To predict the price of oil is dangerous for the professional reputation of the economist." The second: "Prices of oil fall when everyone is absolutely sure they will not fall anymore." This is not just a psychological phenomenon, there is a certain economic logic here. Furthermore, if we are talking seriously about the prices of oil, the problem is not just in shale gas, not only in finding alternative sources, the problem lies in the fact that oil has ceased to be a phenomenon purely of the commodities market.

If we are talking about the fundamental uniqueness of Russia as a participant in modern global economics, then I would cautiously put forward the following hypothesis, which is already being analyzed in a number of works, but has not been fully proven. This hypothesis is about the interweaving, the merging of three basic markets: the commodities market, the stock market and the currency market. Until very recently these were three separate markets which did not influence each other and developed according to different laws. The last few years show us that they have begun to grow closer, and traders can hedge

currency risks on the commodities market, so the problem of the price of oil will not only be a phenomenon on the commodities market, and this means its price will be still more unpredictable. We cannot discuss the price of oil, thinking about how much of it China will need. We can discuss it, thinking about what mood currency speculators are in after some event on the New York, London or some other exchange market. Prices of oil have always been unpredictable, but this state of affairs greatly increases unpredictability, and we need to take this into account when choosing strategies for reform.

G. White:

If I have correctly understood your task, you have created a comprehensive menu of suggestions, tasks, which need to be fulfilled over the period of implementation of the strategy. But how can you describe them so that the whole set of measures will be taken, and not only the sweets, leaving the greens, the vegetables and other, less tasty, elements behind?

Y. Kuzminov:

That's a very good question. First of all, I think that the sectoral policy we have worked out will, of course, be presented in the form of several global scenarios. This will increase our chances of influencing the situation, and increase our ability to attract the interest and support of elite groups. No positive strategy is ever implemented in full. Remember Gref's programme: we calculate that 40% of it has been implemented, and this is no small achievement; in general it has played a significant role. That is one part of the answer. The other part...

V. Mau:

Just one comment, Yaroslav. The programme in 1992 after the severe crisis was implemented in full. It is true, not in three years but in seven, but it was implemented in full.

Y. Kuzminov:

You understand, the situation with the 1992 programme and its subsequent reincarnations, the programme of 1993 etc. – Vladimir and I were then starting out in this noble pursuit – was implemented in many aspects because in the 90s stable social groups had not been formed, which would have been institutionalized, and which reformers would have had to take into account. These groups did not exist and as such were not required to go anywhere as a result of reform. In 2000, a few such social groups had begun to exist. And now, to the extent that relationships have been institutionalised, to the extent that the country has reached a certain level of stability, any reforming strategy becomes more and more compromised. It moves further and further away from what five economists sitting in some hotel could write, simulate and have the government agree to; indeed that is what is needed. There is always the problem of discussion, attempts to gain support of one or another level of society, one or another group of elites. The same will be the case now.

You know, it is a typical journalistic error to say that now power in Russia belongs to Medvedev and Putin and concentration of power has increased over the last 10 years. This is not the case! In our view, in the view of the country's leading sociologists, the level of freedom to run the country is limited every year in accordance with the growth of stable, institutionalized groups of the elite. And, generally speaking, there is nothing wrong with this: every policy is a compromise, a dialogue. And the more often this dialogue takes place, in detail, with discussion of the implementation of these variations in policy, the better for our country.

G. White:

By what criteria can we judge whether the strategy is successful or unsuccessful, whether it is being fulfilled or not? If we look to future years, what will indicate the implementation of serious reforms which many had doubted?

V. Mau:

I repeat what Yaroslav has said: we are not writing a programme of reform, but charting variations in the model, one or another event. Perhaps this will run into a more unambiguous set of reforms. It is in fact much easier to write a consistent programme and prove that it is the best option. What we are doing is much more complicated: we are looking at potential scenarios of development. Everyone has their own opinion, and seeing the positive aspects in other scenarios is also not simple. However, there are general criteria: these are not criteria for the fulfilment of programmes, programmes can vary. There are signs that the situation is improving – this is what Putin was talking about the other day in Geneva. These are the growth of GDP per capita, and of the productivity of labour. Economic science and economic practice have, generally speaking, not worked out anything more than this.

Y. Kuzminov:

My answer will be down to earth. There is this criterion: to what extent will the three-year budget have been modified? If it is not modified, that means we talked a bit and that was it.

G. White:

Good, then I think I will take some questions from the audience. Do we have microphones? Good, please go ahead.

V. Gromkovskiy:

Vladimir Gromkovskiy, from Finematika Group. I have a question for both speakers. This new strategy, or modification of the old strategy, which you are talking about, must lie on some historical path. If we extend – perhaps implicitly – the designated direction of this strategy, then in 20, 30, 50 years we will end up somewhere. You have been saying the whole time, in 3 years, in 10 years. But does the government, or do you as leaders of expert groups, have a point in mind at which we need to, or even want to arrive, in 50 or 100 years' time? Or is this all purely circumstantial: at the moment we have a population shortage so we will encourage immigration, we have a budget deficit or extra money here so we will add to the fund? This is the resolution of momentary problems, and we will basically be following the path of the industrialised world which has already existed for 100 years.

Y. Kuzminov:

I think, first of all, that such forecasts exist, and we are working with them. The classic example is the pensions system, which we need to calculate up to 2040 or 2050. This involves the cumulative pensions system, the balance of labour resources and we are working with these things. As far as the orientation of policy towards the kind of country which should exist in 2050 is concerned, I think that this is a subjective approach, it would be unavoidably subjective. We are living through a period of dramatic renewals of basic technologies, which bring about progress. Roughly every 7 -10 years we have another technological revolution and we cannot predict all of them. For this reason, despite my close acquaintance with Velikhov, Kovalchuk and Kirienko, I think we cannot plan the global energy balance over 50 years. Here is a good example of our limitations. There could be a boom in life expectancy, 120-150 years - this is an absolutely realistic possibility. We haven't behaved ourselves, we have eaten a lot, but our children could live much longer than us. This radically changes the demographic forecast and the forecast for labour resources. If we are going to talk about

temporality, any one of our visions of the future is temporary: we are people, not gods.

V. Mau:

Of course it was also difficult to make predictions 100 years ago, and even more so now. I would like to remind you that the forecasts of the third programme of the CPSU were strictly scientifically based and, for example, the Kennedy administration very seriously discussed the prospects of the implementation of this programme by 1980. But there are three most basic scenarios, three variations in development, which must always be borne in mind, and we do bear them in mind. Over the past 300 years – or, more precisely, 200 – Russia has developed with a 50 year gap behind France and Germany, a difference of two generations, and whatever we have done, no matter what government we have had, this has been the case. At times the gap has closed a little, at times it has grown a little wider. We are constantly setting the task of closing it completely, but have never yet succeeded. This is not the worst possible scenario: take the state of France for example when de Gaulle came to power; I think that would be the worst case scenario. The position of China, which for 200 years had been on the same level as Britain, then fell away, and is now catching up again – I think this scenario is also worse.

But even so, 200 years of development along these lines does not guarantee its continuation forever. The second variation, is to take measures to reduce the gap. Only very few countries, as we all know, have been successful in this, but all the same it is not out of the question. Finally, let us not forget that there is a third variation for the development of events, which is just as likely: this is the increase of the gap. And we know that in the resource economy of any country over the past 500 years, starting with Spain in the 16th century, as soon as we start living past income, the gap begins to widen. I always use the following example: 50 years of the influx of gold and silver from the Americas after their

discovery by Columbus fully set up the largest European power with the strongest army – Spain, which quickly worked out...

Y. Kuzminov:

A very well organised economy...

V. Mau:

...quickly worked out, after 30 years of such abundance, that it was much easier to buy from England and France than to produce things themselves, leaving them free to wage war far and wide across Europe. After this there followed defaults, despite the rapid growth of budget profit, and over the next 500 years it sort of... The problem is that stability is not guaranteed, and this is important. Generally speaking, prospects for the next 50 years hold three basic possible scenarios: to maintain the status quo, to catch up and overtake, and to fall behind.

RIA Novosti:

Yaroslav Kuzminov, I have two questions, if I may. Yesterday Dmitri Medvedev announced that it is necessary to create a capital federal district and expand the boundaries of Moscow. What is your evaluation of this project, will it allow for the effective sharing of the budget? And the second question: by how much is it necessary to reduce the number of people in the police force and at whose cost, and won't this create pressure in the labour market? Can these people find work?

Y. Kuzminov:

In my opinion, the number of people in the police force can be reduced over the next five years by roughly a third; this is a mild scenario, and I think that these people will indeed find work in the labour market. And by the way, this is a

chance to raise the level of security, security on the streets and security for businesses. This measure will free not only these people, but around another million who will not work for the government, and will be hired by private companies as security guards. Go into any shop in the provinces. You will see only one saleswoman and one old man there. We can considerably limit the growth of immigration, which is worrying many, through investment in business and security on the streets.

As far as a district of the capital is concerned, yes, absolutely, this is a burning issue. I shall give an example: in Moscow, the labour market includes 6 million people; 4 million of these people live in Moscow city. It is senseless to analyze or plan something. We are now conducting a whole set of research for Sobyenin's government. Vladimir Mau and I are also engaged in this, but we are unable to conduct a survey of the population. In working out policy for the city of Moscow we must go out quite far into the Moscow region. It is an integrated economic complex, and I think that all this is straightforward. But we must know in detail which model will be taken; will the whole of the Moscow region be included or just the so-called 'Moscow suburbs'. This needs to be discussed. But what the President has said, I think is correct.

R. Mamonov:

Roman Mamonov, from *The Voice of Russia*. I would like to continue on Medvedev's topic: does the Strategy 2020 presently being worked on somehow take into account Medvedev's initiative rejecting the construction of state capitalism, bearing in mind that the strategy is associated with Putin? And my second question, connected with this one, is about the decentralization of power and delegation of a large amount of authority to local governments.

V. Mau:

To be honest, we do not now have state capitalism, although there is discussion of it, and the theory is very popular. I think it is enough to look at the available materials to see that we are not discussing, as one of our possible variations in the development of events, the strategy of building state capitalism. Generally, I will of course say that state capitalism is more a political term, and we must therefore discuss what is meant by it. If we are talking about state corporations, about the necessity for reform, rejection of this model, then this decision was taken long ago. Generally speaking, in our discussion the problem of state capitalism does not feature, we are dealing with the problem of stimulating effective economic growth. And what was the second question?

R. Mamonov:

The delegation of authority to local governments.

V. Mau:

Yes, but Yaroslav has spoken about that in detail. Here there is, again, a set of technical problems. Budget federalism at a regional level and the strengthening of tax functions are technologically clearer. As soon as you move to the municipal level, many technical problems arise: the problem, for example, of distances between places of work and places of domicile. Municipalities are small foundations, unified laws are practically not formulated there, redistributive processes within the federal territory are much more likely and often unavoidable. This is understandable, because taxes are collected in one place and spent in another: what more or less balances out in the federal territory cannot balance out at the municipal level. Of course, the problem of the tax base needs separate discussion: to what extent should there be transfers, in which taxes. There is also the politico-economic problem of the relationship between towns and villages: to what extent is it worth supporting often ineffectively developed villages at the cost of an effective town?

You understand, you have asked a question to which one could answer "Yes, municipalities mean everything to us!" But if we consider seriously the budget framework which Yaroslav has told us about, then the budget problem is solvable, if you want to feed all the municipalities at once. The territory of Russia is undergoing a transformation: regardless how angry people were 25 years ago with Tatiana Zaslavskaya for her theories about the villages without a future, they do exist and this is a real problem. Should you educate five pupils badly in a village or close the school, send the children to good schools, build roads? To this suggestion you receive the following answer: if there isn't a school, there won't be a village. This is a complicated social question, which can really only be solved at a regional level, it cannot be solved at a municipal level. The region must be prepared to pay for the maintenance of the school, but clearly will not ensure a good quality of education if there are only a few pupils attending. It is, generally speaking, not the job of the federation to insist that this shouldn't be the case. The responsibility should lie with the region.

The problem of demographics and population growth. We have talked about this in detail and Yaroslav Kuzminov has partly made reference to it. Economic growth presupposes population growth, and we do not have population growth. But growth does not necessarily mean the physical growth of the population. The redistribution of the population across the country's territories, concentration, the growth of population through internal migration also counts as population growth, and this is a separate driver of economic growth, just like, for example, the liberation of workers in the uniformed services. As soon as we begin seriously to discuss the question of increasing the authority of the municipalities – not necessarily about municipalities themselves – it's good; Solzhenitsyn wrote about that, Lenin wrote a lot of good things about that. As soon as we look at this on a concrete, realistic level, many real and complicated nuances arise, which must be considered. And here there are no simple solutions.

Y. Kuzminov:

The term 'state capitalism' is, I agree, more a metaphor, but we all understand what is meant by this metaphor. Generally speaking, there are two types of process which occur in our economy and are discussed in connection with the concept of state capitalism: these are the formal presence of the state in the capital of the largest producers; and types of informal influence of individual government representatives in real business. These are different processes. They are connected, but in economics, generally speaking everything is connected. President Medvedev's initiative was directed towards limiting the presence of the government, including its formal presence, in privatization. I see this as positive, but think that the reduction of the government's informal influence on business is far more important, the informal regulation of the market, the informal acquisition of advantages on the market. Here as well, the antidote is more or less clear. We must limit pressure from government hands, which is at the moment very strong: this means supervisory bodies, law enforcement bodies, their departments of economic security; the introduction of law enforcement elements into business. Thirdly is the continued strengthening of the independence of the judicial system, and, by the way, much has been done during Putin's presidency and during Medvedev's presidency towards this third aim.

G. White:

Then I, as moderator, will ask another question. You have both made reference to previous plans, programmes, and strategies, the writing of which has led to successes in various years. What lessons can be taken from this experience, in order to make the results of your work more effective, more achievable?

V. Mau:

That's a good question. I'll say, a little romantically: firstly it is a limitation of the dangerous arrogance of the economist. One of Hayek's books was called *Dangerous Arrogance*. An economist's understanding that there is a lot he does not understand does not mean a withdrawal of responsibility. It is not for nothing that the first economists were doctors: the general principles and mechanisms are similar, and whether the patient lives or dies depends to a certain extent on God. And from this perspective, an economic miracle is a phenomenon for future economic historians. Historians of economics very clearly explain why it is that when two countries did the same thing, one was successful and the other was economically destroyed. This understanding of one's own limitations is important. It is important for interacting with politics. I think an expert should never force his or her opinion on a politician, because a politician has to relate to his voters, and a monarch to his subjects. This relationship escapes the boundaries of economic logic. Economic logic is very important here, but the relationship with society is, all the same, a political relationship.

From this perspective, in my opinion, an economist, a responsible economist, a developer of programmes, must consider measures with the understanding that they probably will not be realised. We must point to these alternatives, we must draw attention to them in society, make them the subject of political discussion. But generally – I don't know if this is an optimistic or a pessimistic point of view – all the experience of the past 20 years shows that every intelligent economic piece of advice is implemented, sometimes only after a generation, but all the same it is implemented.

From the audience:

OPORA Russia. We have recently encountered the new initiative of the leader of the party, Vladimir Putin, about the creation of a popular front. What is your opinion on this?

Y. Kuzminov:

The implementation of policy over the past 20 years has demonstrated certain, relatively stable phenomena: the authorities must conduct objective policy, which contains a serious element of liberalism. It is complicated enough to mobilize stable groups of the population to constant support of this policy under the conditions of an undeveloped political system. In the 90s there were attempts to create a party which would have supported the efforts of the authorities on the basis of rational but broad consensus. These attempts at creating such a party, which were undertaken until 2000, were half-successful. In the year 2000, a political mechanism was successfully created, which continued to work for a relatively long time, for 12 years. Naturally, it has its political sell-by-date, just as a party in power has its sell-by-date. The thing is, being a party in power is very complicated. On one hand, it can gather together its most constructive elements, which want to do something. On the other, it becomes more and more a mechanism for broadcasting what the executive authority wants.

I think that this kind of negative process is happening in United Russia and the leaders of United Russia are seriously concerned about this. This All-Russia Popular Front is an attempt to consolidate those social powers which are ready to develop and support the policy which is being introduced by the country's leadership, on the condition that their interests are accounted for. This is yet another appeal from the country's leadership, in this case from the leader of United Russia, to social groups which have always been present in United Russia, but who have their own interests. It is an attempt once more to summarize these interests – the interests of small businessmen, the interests of large-scale business, the interests of the student masses, the interests of teachers, the interests of doctors – by taking account of the views of professional organizations. This is a perfectly constructive expression of political interests and a form of pre-election dialogue between the voters and the governing party, which would like now to receive a mandate to stay in power for

another five years. This is completely natural. I think that analogies between this and some kinds of post-communist forms – in eastern European countries there were also all sorts of fronts – are not entirely correct. It is not an attempt to create something false, copying western democracy, but a real mobilization of support in exchange for the concrete, articulated interests of certain social groups. That is how I would answer this question.

G. White

Our time has now come to an end. Does anyone have any final words?
Colleagues, thank you very much.