The Regional Agenda in Alternative Plans for Russia's Economic Development

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"*Our country is rich but there is still no order here.*"
Aleksei Tolstoi

This paper examines the political options for Russia's economic development in the wake of the August 1998 financial crisis, with a particular focus on the regional dimension. This is a difficult task, since political and economic decision-making by regional elites is dominated by a short-term survival mentality that militates against a long-term development strategy. The first part of the paper discusses why it is so hard to find alternative plans for Russia's economic development, and the second half discusses what issues are shaping regional politics and must be taken into account when developing such an alternative development strategy.

The August Crisis

The August 1998 financial crisis was a watershed in Russia's post-1991 economic development. The crisis caused a 75 percent devaluation of the ruble, the collapse of the banking system, and an effective default on most foreign debt payments. The actual economic impact of the crisis was if anything less important than its psychological impact. It signaled to Western observers something that most Russians had known for a long time - that the ambitious program to build a market economy in Russia had gone badly astray. Economic recovery was still nowhere in sight, and a corrupt and arbitrary economic system had taken root in Russia that created a hostile environment for foreign investors.

In August 1998 the illusion that the Russian economy was still "on track" for the market came crashing down. The immediate cause of the August crisis was the chronic fiscal deficit, which was in turn the product of an essentially unreformed economy in deep recession that produced little wealth, and a government unable to tax those profits that were being made. Experts are still divided over whether the August crisis was inevitable given Russia's deep structural flaws, or if it was just bad luck, the product of unfavorable international circumstances and some poor policy responses. The two leading policy errors, made back in 1995 and sustained to the bitter end, were the decisions to fix the ruble exchange rate at too high a level, and to finance the yawning government deficit through international borrowing.

Vladimir Popov has shown that the ratio of the ruble exchange rate to purchasing power parity (PPP) rose from around 50 percent (the level of most East

European currencies) to 70 percent between 1995 and 1997.[1] This priced Russian manufactures out of export markets and exposed them to fierce import competition. The IMF and Russian government set the ruble at too high a level because they were over-optimistic about the rate at which inflation would fall and about their ability to get the fiscal deficit under control.

Negative trends in external factors increased the pressure on the exchange rate. Russian foreign trade slipped into deficit in July 1997, for the first time in a decade, which was taken by many as a signal that devaluation was overdue. Russia still finished 1997 with a $3.3 billion trade surplus, but was running a $5.8 billion annual deficit by mid-1998. Second, the Asian stock markets started to fold in October 1997, causing international investors to flee from emerging markets. Third, the world recession caused the price of oil to plunge from an average of $18 a barrel to a mere $11 by the end of 1998: a severe blow to Russia which relied on oil and gas for half its export earnings.

In light of these trends, there were increasing calls for a devaluation of the ruble - from maverick economist Andrei Illarionov to financier Boris Berezovskii. Outside observers discounted these concerns, assuming that Russia was "too big to fail." They believed that the international financial institutions would always rally to shore up the reform efforts of the Yeltsin administration, and that defending the ruble exchange rate would be the chief indicator of those efforts. Devaluation would cause panic in international markets and would produce precisely the crisis that it was supposed to avoid. Indeed, the IMF did come through with a $22.6 billion aid package on 20 July), including $4.8 billion in ready cash, which it was confident would protect the ruble against speculative attack.

Concerns over the ruble's stability were reflected in the market for treasury bills (GKOs). GKO nominal rates averaged 63 percent in 1996, fell to a low of 26 percent in 1997 (when inflation was 11 percent), but started to rise again in 1998.[2] The rate hit 130 percent by June, by which time the total stock of GKOs was about $40 billion, of which about half were held by foreigners or by Russian banks who had borrowed from foreigners to buy the bonds. The GKO pyramid was by then a full-blown Ponzi scheme, with new bonds being used to pay the interest on old bonds. By June the government was finding it hard to find buyers for GKOs even at rates in excess of 100 percent. This left interest payments accounting for some 30 percent of federal government spending. In July 1998 to reduce the exposure to a possible ruble devaluation the government managed to convert $6.4 billion of GKOs into Eurobonds at 15 percent interest, denominated in dollars. That still left $11 billion of GKOs falling due by the end of September.

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1 Vladimir Popov, "Will Russia achieve fast economic growth?" *Communist Economies and Economic Transformation*, Vol. 10, No. 4, 1998, pp. 421-49.

2 Economic data in this paper is mostly taken from *Russian Economic Trends* quarterly and monthly reports.

In return for its bailout, the IMF insisted on an emergency package of spending cuts and tax increases to bring the fiscal deficit below 3 percent of GDP. Meeting on 15 July, the State Duma accepted 12 of the government's proposed bills and rejected only two. Yeltsin anyway announced his intention to enforce by decree the tax increases which the Duma had rejected.

In the second week of August, as Russian government officials dispersed for their vacations in exotic corners of Europe, George Soros dropped a bombshell with his 13 August letter to the *Financial Times* predicting that Russia would have to devalue the ruble. On 17 August the Russian government announced a 90 day moratorium on foreign debt payments and the suspension of GKO payments, and allowed the ruble to devalue from 6/$ to 9/$. The financial system froze up, prices leapt 50 percent, and by 9 September the ruble had fallen from 6/$ to 21/$. Subsequently the ruble stabilized at 25/$, while inflation slowed, running at an annual rate or 97% over the seven months after the crisis (and 84 percent for calendar year 1998).

The August crisis shattered the Russian banking system, disrupted Russia's trade with its neighbors, and pushed many firms into bankruptcy (especially those who had taken dollar loans). However, dire predictions of hyperinflation, starvation, and economic turmoil did not materialize. The devaluation had the effect of curtailing imports and boosting demand for some Russian products, with GDP showing positive growth by March 1999.

The Lessons of August

The reform model called into question by the August events had dominated Russian government policy - and Western policy towards Russia - since 1992. Policy was based on the assumption that a rapid transition to a full-blown market economy was preferable to gradual or partial reform, and that Russia was not a "special case" but would respond to the same medicine being applied in other countries from Poland to Latin America. The program hinged on the speedy introduction of radical reforms (liberalization, stabilization and privatization) by a strong central leadership - a leadership which had to be friendly to the West and selected through democratic elections.[3] Erratic behavior by Boris Yeltsin; the absence of rule of law and evidence of widespread corruption; and the lack of economic growth (except for an anemic 0.8 percent rise in GDP in 1997) caused many to question the wisdom of the Western approach to economic transition in the former Soviet Union. Still, the orthodox approach remained dominant until the dog days of August 1998.

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3 The most systematic explanation and assessment of the Washington Consensus can be found in: *World Bank Development Report 1996: From Plan to Market* (Washington DC: World Bank, 1996). See also John Williamson, "Democracy and the 'Washington Consensus,'" *World Development*, Vol. 21, No. 8, pp. 1329- 1337.

Until August, the assumption was that Russia was poised to break out of its transition recession. By then inflation had been conquered, falling to an annual rate below 10 percent by spring of 1998. From 1995 the ruble held its value against the dollar within the corridor announced by the Central Bank, and even gradually appreciated in real terms. Privatization had seen 70 percent of productive assets transferred out of state ownership into "private" hands. In 1997 the Moscow stock exchange was the fastest-growing in the world (recording an 85 percent rise). Up to 1998 Russia ran a robust trade surplus, and its foreign debt exposure (as a proportion of export earnings and of GDP) was comfortable by international standards. The assumption was that in 1998 the new private owners would take advantage of the stable macroeconomic climate to invest, mainly though foreign borrowing, and restart economic growth.

Alas, this scenario did not materialize. The August crisis scared away foreign investors for the foreseeable future and punctured the liquidity of the bank holding groups that were supposed to oversee the restructuring of Russian industry.

The August crash caused a flurry of finger-pointing and soul-searching in Western capitals, especially Washington. After a few weeks, however, the situation calmed down. The worst-case scenarios floated by some pundits failed to materialize - there w as no communist putsch, no fighting in the streets, no hyperinflation, no mass starvation. The Primakov government which took power in September deserves much of the credit for restoring the business-as-usual atmosphere, although it was regarded with some suspicion from Washington because of the presence of communists and ex-KGB types in its ranks.[4] (In fact about half the Primakov government, including most of the economic positions, was occupied by young reform-oriented ministers held over from the preceding Kirienko government.)

The most immediate Western response to the August crisis was the decision in November - tak en independently but simultaneously by the US and the European Union - to dispatch food aid totaling o ver $1 billion ($850 million from the US and $460 million from the EU) to Russia over the course of the next winter. This food aid was a substantial amount, equal to 20 percent of annual Russian grain sales and 11 percent of meat sales.[5] The food aid, unfortunately, will have the effect of driving down prices for Russian food produce, making it even more difficult for hard-pressed Russian farmers to cover their costs. The 1998 harvest (officially, 48 million metric tons) was indeed the poorest since 1962, but Russia still had grain stored from the bumper harvest of 1997, and few Russian specialists believed that the country faced an absolute food shortage in the forthcoming winter. The problem was one of distribution - getting the food to the poor and to the geographically distant regions of the east

4 For a defense of its record, see Yurii Masliukov, "The fault of the Primakov government is that it saved Russia," *Pravda*, 19 May 1999.

5 Interfax, 28 May 1999.

and north where transport costs are prohibitive and the time-window for transport all too short.

The decision to send food aid seems to have been driven entirely by the desire to please domestic farm lobbies in Europe and the US by disposing of surplus food stocks. An additional factor was a desire to help the Russian government. The food aid would be sold inside Russia at the going market price, with the proceeds going into the coffers of the national government. Ironically, the same year that this "altruistic" program was being launched, the Nobel Prize for economics was awarded to Amartya Sen, who argued in his seminal study of famine that in most cases low purchasing power is the key problem and not an absolute shortage of food.[6] Sending food does little to help a famine-struck region since it undermines revenue for local farmers: the most effective strategy is to give money to the poor. One can only conclude that Western policy is primarily driven by various political considerations that may not correlate with the long-run development needs of the Russian economy.

The Search for an Alternative Policy

While the farm lobby was having its way, the IMF called an unprecedented meeting on 30 November 1998 at which outside specialists were invited to critique the Fund's policies towards Russia since 1992. However, the temporary willingness to question policy assumptions soon gave way to a reformulation of the Washington consensus. The basic direction of the preceding policy was reaffirmed, although optimism about its imminent success was dropped.

Why was the IMF unconvinced that the August crisis revealed any fundamental flaws in its policies? Its reasoning was threefold.

First, the August crisis was put down to bad luck rather than structural flaws. The Russian government ran into a liquidity problem in mid-1998 due to the impact of the October 1997 Asian crash and the ensuing 40 percent slump in world oil prices. The oil price fall hit Russian export earnings, while the "Asian flu" caused an outflow of funds from risky emerging markets worldwide. If these contingencies had not occurred, so the argument goes, the Russian government could have ridden out the crisis.

Second, the IMF still believed that there was no real alternative to the market transition policies urged on Russia since 1992. The policy's failure was not a result of the advice being unsuitable for Russian conditions. Rather, the problem was that Russian leaders failed to follow through on this sound advice. Instead, they manipulated the reforms to enrich themselves while blocking competitive market forces. Hence, even with the benefit of hindsight, after August the IMF and most Western governments continued to argue that the reform package offered to Russia in 1992 was the correct one. Even knowing what they now knew about the transition recession and the August crash, they would still have

6 Amartya Sen and Jean Dreze, *Poverty and Famine* (Oxford: Oxford University Press, 1984).

pursued the same policies. Eventually, they argue, Russian leaders will come to their senses and see the need to embrace sound market reform policies. After all, it took 20 years before Argentina's leaders saw the error of their ways and embraced market liberalization.

Third, the IMF argued that political factors on the US side of the Atlantic undermined their efforts to impose strict conditionality on the Russian reformers. Russia's size and nuclear weapons capacity mean that it would always be treated differently than say Bolivia in negotiations over loan conditionality. The West was not willing to walk away from the Russian imbroglio, to allow the country to default or plunge into Bulgarian or Albanian-style economic collapse. Given this situation, the IMF had to make the best of a bad job, using what leverage they had to try to get the Russian government to adopt more effective policies, and shoring up the reformist wing of Russia's hydra-headed government.

Hence the IMF's policy towards Russia continued on the same course in 1999. For political reasons, and to avoid the disruption of a full and formal default on international loans, the IMF advanced a further $4.5 billion in lending to Russia in 1999 (just enough to cover the repayments it owes the IMF for that year), in return for promises to delay the planned VAT cut, to establish new export tariffs, and to reform income tax. Realistically, there is little hope of getting the sort of strong central leadership which market reform needs until Boris Yeltsin leaves the presidency. Hence the IMF is effectively marking time until the June 2000 presidential election.

From Jacobins to Girondins ?[7]

The World Bank has shown itself more willing than the IMF to admit that a policy rethink might be in order. This is part of a general review of Bank policy worldwide that has been underway since the arrival of James Wolfensohn as president in 1995, and comes in recognition of the failures of the infrastructure project lending approach pursued in the 1970s and 1980s. (During that time, Bank officials privately admit, in some countries one third of the loans were stolen by local politicians).

In a pivotal paper, chief economist Joseph Stiglitz has argued that "the failure of privatization to provide the basis of a market economy was not an accident, but a predictable consequence of the manner in which privatization occurred"; since it should have been clear that "the oligarchs would either take money out of the country or use it to capture the political process and protect their ill-gotten gains."[8]

7 The names of two factions in France in the wake of the 1789 revolution. The Jacobins advocated strict adherence to revolutionary principles while the moderate Girondins, drawn from the professional classes, favored devolution to the regions.

8 Joseph Stiglitz, "Whither reform? Ten years of the transition," paper presented to World Bank Annual Bank Conference on Development Economics, Washington DC, 28-30 April 1999.

Stiglitz concludes that reforms would have had more chance of success if they had been approached in a bottom-up rather than top-down manner. More attention should have been devoted to maintaining the "glue" that holds society together and to utilizing the social capital in existing enterprises. He underlined the arbitrariness of the assumptions behind the privatization program pressed on Russia, with the illusion that ownership and control are separate and that external investment fund ownership is the solution to governance problems. Instead he proposes "a strategy of decentralization to push power down to the levels where people can use local institutions (e.g., enterprises, associations, unions, and local governments) to protect their own interests and marshal their resources to incrementally rebuild functioning institutions on a broader scale."

Stiglitz's "small is beautiful" approach is appealing. But is it a realistic alternative? For one thing, it seems to overlook the fact that much of the Russian privatization process was in fact decentralized and under local control. 70 percent of firms opted for the "worker buy-out" option, in which typically control passed into the hands of incumbent managers. The well-publicized cases where outside owners took control (Noril'sk Nickel, Tiumen' oil) are the exception rather than the rule, and just as much of the stealing, one surmises, was done by local elites as by Moscow plutocrats.

Second, one wonders what kind of political scenario is required in order to turn the Stiglitz alternative into reality. The IMF model, for all its flaws, did have a political implementation process in mind - centrally -managed reforms by a technocratic government enjoying Western assistance. It is less clear how Stiglitz's bottom-up privatization would work in a way that would be less corrupt and more conducive to growth than the existing pattern.

Given the exhaustion of the IMF's strategy and the preliminary nature of the Stiglitz alternative, it seems unrealistic to expect an alternative policy to emerge from the international community in the near future. Indeed, it is very difficult to come up with even a paper outline for an alternative strategy, still less to sketch out a program for its implementation. The same factors that undermined the shock therapy approach make it difficult to come up with any plausible alternative development strategy. Such factors include power-hungry and paranoid leaders, selfish and corrupt elites, the absence of legal and capitalist traditions, and the specific economic geography inherited from the Soviet era. A "gradualist" alternative, if viable at all, would have had the best chance of success early in the transition process, when old institutions and elites were still intact. Each passing year makes it more difficult to imagine a centrally-run transition.

Increasingly, the relevant paradigm for understanding Russian economic development will not be a centrally-managed transition model, but an inchoate process of contradictory and competing political and economic trends, played out across Russia's vast regional mosaic.

REGIONAL TRENDS

This half of the paper explores the main features of regional politics and political economy in the wake of the August crisis. The complex and directionless character of these trends makes it difficult to formulate a strategy of economic revival capable of attracting and sustaining a viable political coalition.

Regional Leaders - Stronger, but Not All-Powerful

It is generally agreed that the August crisis had the effect of strengthening the power of regional elites vis-a-vis the center. The collapse of the Sergei Kirienko government and the perceived failure of the market reform strategy left President Yeltsin extremely vulnerable to political attack - for example from the Communists in the State Duma, who were just putting the finishing touches to their impeachment charges when the crisis broke. Hence Yeltsin needed to make concessions in political and economic policy to regional leaders, to directly secure the support of the Federation Council (which consists of regional executive and legislature heads) and indirectly to blunt the attacks emanating from the State Duma, where the Communists were the largest party.

The power of Russia's regional governors had already been growing over the previous 2-3 years. Back in 1991-92 they had been appointed to office by President Yeltsin, but they moved over to a system of popular election in 1996. This could be expected to have the effect of weakening the center's control over regional leaders, since the governors' appointment would henceforth be decided by local voters and not by the Kremlin. However, having to put themselves up for election would not necessarily mean that the governors would be strengthened. They were still dependent on Moscow for finance and favors, and they now faced the additional risk of being voted out of office - a fate which befell about one half of the incumbent governors in the 1996-97 round of elections. In elections held in 1998 for example the governors of Penza, Lipetsk, and Smolensk oblasts failed to win re-election, while Krasnoiarsk krai governor Valerii Zubov fell to challenger Aleksandr Lebed' in May 1998.[9]

Moreover, elections of regional assemblies and big-city mayors created other local officials with a democratic mandate who were potential challengers for the governor's chair. As they face another round of elections in 1998-2000, governors have had to devote a considerable amount of attention to fending off such rivals. This weakens the power of the governors vis-a-vis the center. Also, it complicates the task of those governors who seek to create a regionally-based "party of power" to represent their collective interests at national level. Personal rivalries aside, the main factor thwarting such efforts of course is the diverging political and economic interests of the various regions.

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9 An invaluable source, upon which much of this paper is based, is the East West Institute *Russian Regional Report* (hereafter *RRR*).

Leaders of the ethnic republics seem to have fewer problems than regional governors in staying in power.[10] Unlike the regional governors, they arranged to be directly elected already in 1991-92 (appointed, in the case of Kabardino-Balkariia), and enjoyed considerable constitutional autonomy from the federal center. In the course of 1998 Ingushetiia's President Ruslan Aushev, Chuvashiia's Nikolai Fedorov, Mordoviia's Nikolai Merkushkin, Bashkortostan's Murtaza Rakhimov, and Dagestan's Magomedali Magomedov all easily won re-election (in the latter three cases by manipulation of the electoral rules to keep out opponents.) Two exceptions were North Osetiia, where Aleksandr Dzasokhov defeated incumbent President Akhsarbek Galazov, and Kareliia, where Communist Prime Minister Viktor Stepanov lost to Petrozavodsk Mayor Sergei Katanandov.

Apart from the problem of staying in office, the power of governors is also checked by the need to secure support for their policies in regional legislatures and executive organs. One factor working in their favor is the weakly developed party system. Few national parties have a presence in regional legislatures, although the Communists did well in 1998-99 in regional elections in Smolensk, Krasnoiarsk, Orel, Orenburg, Omsk, Volgograd, and Sverdlovsk.

The August crisis did not lead to an upsurge of support for the Communist Party. Governors were not perceived as responsible for the economic crash: on the contrary it gave them a chance to introduce emergency measures to try to protect local people from the effects of the crisis. Perhaps the most important way in which the crisis strengthened the power of regional governors was that it weakened the financial independence of regional media (already quite precarious). Independent regional newspapers and TV (that is, those not already subsidized from the regional budget) were heavily dependent on advertising revenue - which nose-dived after August.

One strategy governors used to improve their election chances was to move forward the date of their next election, in order to leave their opponents less time to organize, and to deny them the opportunity to combine their race with party campaigning for the December 1999 State Duma elections. This technique was pioneered by Belgorod Governor Yevgenii Savchenko, who won re-election on 30 May 1999, seven months ahead of schedule.[11] The governors of Novgorod, Omsk, Tomsk, and Moscow followed his example in pushing their elections forward.[12]

Primorskii krai governor Evgennii Nazdrantenko led the field in manipulating election rules to fend off opponents. His volatile confrontations with local opponents peaked in the summer of 1997, when the federal government tried - and failed - to remove him from office. By 1999 Nazdrantenko had

10 Natan Shklyar, "Governors emerge stronger," forthcoming in *Annual Survey of East Europe and the Former Soviet Union* (New York: ME Sharpe, 1999).

11 In that election the Agrarian Party broke with the communists and backed the incumbent.

12 *RRR,* No. 20, 27 May 1999.

patched up his relations with the Kremlin, but his battle with his nemesis, the ex-mayor of Vladivostok Viktor Cherepkov, continued to unfold in the court system and on the streets of Vladivostok. In May 1999 Vladivostok failed in its 16th attempt to elect a city council. The elections were declared invalid because the turnout, at 7%, was below the legally required 25%. The January 1999 elections, which were won by Cherepkov supporters, had been annulled ex-post by Nazdratenko allies.

Many regional leaders have had problems dealing with local assemblies and elected mayors. Saratov Governor Dmitrii Aiatskov fired Marx city mayor Ivan Kosyrev, but the city duma refused to approve the governor's nominee, agricultural enterprise director Nikolai Dorovskii, as mayor. Leaders in regions like Kursk and Voronezh were trying to impose the sort of top-down control enjoyed by Nazdratenko in dealing with local elected rivals. It was already in place in republics like Tatarstan, Bashkortostan, and North Osetiia.[13] In similar vein Komi Republic in 1998 abolished the direct election of mayors, who were instead to be appointed by councils from nominees from republic president. The change was challenged through the court system. In Kursk, Aleksandr Rutskoi wanted to hold local referenda to abolish local councils, while Voronezh's Ivan Shabanov wanted mayors to be appointed by councils on the nomination of the governor. In Voronezh in April 1999 the city council impeached the mayor and elected a new one after disbarring a group of deputies who held administrative positions. Hence the city had two mayors and may be set to follow the "Vladivostok variant."[14]

Another crucial factor constraining the governors' power was their relationship with local business elites. While much of Russian industry is fatally weak, some business leaders are independent actors at national and regional level - as Lebed' discovered after taking office in Krasnoiarsk, when he fell out with his former backer, industrialist Anatolii Bykov.[15] Juggling the demands of Moscow, voters, regional politicians, and local business elites leaves little scope for governors to worry about long-term development strategies. Hence for example the powerful and charismatic governor of Kemerovo oblast', Aman Tuleev, faced strident opposition from the chair of the oblast' assembly, Aleksandr Filatov. Tuleev's adversaries were backed by the financial group Moscow Metallurgical Investment Company (MIKOM), which controlled such pivots of local industry as Kuznetsk Metallurgical Combine, the Novokuznetsk Aluminum Factory, and the Prokopevskugol coal company. However, Tuleev's bloc managed a clean sweep in elections on 18 April 1999, winning 34 of 35 seats in the oblast' council and all 11 local executive races.[16]

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13 *RRR,* No. 23, 17 June 1999.

14 Andrei Muchnik, in *RRR,* No. 17, 6 May 1999.

15 Betsy Mackay, "Lebed hoped Siberia post would be his ticket to Moscow," *Wall Street Journal Europe*, 27 May 1999.

16 *Kommersant Daily,* 13 April, 20 April 1999.

Presidential Ambitions

Much of the politics of regional governors since August has been bound up with the intense maneuvering to find a replacement for Boris Yeltsin as president of Russia. The elections looming in June 2000 dominated the political landscape. Even the State Duma elections scheduled for December 1999 were increasingly being regarded as mainly a "primary" for the presidential race. This left little political space for devising collective strategies to reverse Russia's economic decline. (A similar pattern was playing out in Ukraine, where economic reform hopes were also on hold until the next presidential election.)

Despite the leakage of power from Moscow that has occurred since the Soviet collapse, Russia's system of what Igor Kliamkin has called "elective monarchy" still places a huge concentration of power in the hands of the individual who is president. The difference from traditional Tsarism is that the modern ruler of the Kremlin has to get himself elected every four years. Regional leaders have an important role in this contest through their influence over local electorates (especially through their control over local media). They have a variety of objectives in the presidential campaign. Some, such as Moscow mayor Yurii Luzhkov, Krasnoiarsk governor Aleksandr Lebed', or Samara governor Konstantin Titov, aspire to the president's chair for themselves. Most of the governors, however, merely wanted to ensure that a hostile or powerful figure does not accede to the Kremlin, or they seek to win some pork-barrel favors from the Kremlin in return for their support.

The logic of pork-barrel encourages governors to "bandwagon" behind an obvious winner, as with Yeltsin in 1996 (you don't want to risk supporting a loser). However, the 2000 race was wide open, so it was difficult for governors to pursue this bandwagon strategy. The political party Nash Dom Rossiia (Our Home is Russia) was created back in 1995 in an effort to create a "party of power" to attract the loyalty of regional executives. However, it was weakened by the rivalry between the presidential administration and the government headed by NDR's founder, Viktor Chernomyrdin. Once Chernomyrdin fell from government in March 1998 NDR lost its raison d'etre, since you cannot be a "party of power" out of power.[17]

Among the leading contenders for the presidency were two regional figures - Moscow Mayor Yurii Luzhkov and Krasnoiarsk governor Aleksandr Lebed'. While in 1997 the pattern was to recruit regional leaders to bolster the federal government, in 1998-99 that trend went into reverse. An increasing number of national leaders sought a place in the provinces, either as a comfortable place to sit out the political storm, or as a spring-board to return national politics (through the guaranteed seat on the Federation Council for example). Former putchists Vasilii Starodubtsev (August 1991 coup leader) and Aleksandr Rutskoi (October 1993 rebel) were elected governors in Tula and Kursk respectively. Boris Federov,

17 David Hoffman, "Russian party victim of itself," *Washington Post*, 13 February 1999.

the former finance minister and one of the leaders of the liberal bloc Pravoe Dela (Right Cause) announced that he would run for the office of Moscow oblast' governor in December 1999, while ex-premier Sergei Kirienko will challenge Luzhkov for the office of Moscow city mayor. Even Liberal Democratic Party leader Vladimir Zhirinovskii thought it worth his while to run for the Belgorod governorship in May 1999 (he placed third, with only 18% support).

Luzhkov's presidential campaign took off with the launch of his Otechestvo (Fatherland) political movement on 19 November 1998, which aspired to be the new regional party of power. Luzhkov had the advantage of a track record as a successful and popular mayor of Moscow; and as a persistent critic of Yeltsin's economic and foreign policies he can attract support as an "opposition" figure not responsible for Russia's current ills. Otechestvo released its manifesto on 10 April 1999,[18] a document which blasted the oligarchs for bringing Russia to its knees while simultaneously trying to appeal to the interests of both small businessmen and those who yearn for the security of the Soviet era. This combination of apparently contradictory attributes is very much in evidence in the brand of capitalism which Luzhkov has built in Moscow. Luzhkov has been skillfully cultivating support across Russia - promising for e xample to open a chain of Otechestvo vodka stores that will sell vodka produced in Novosibirsk (hence winning the support of governor Vitalii Mukha). In elections held on 4 April 1999 for the local parliament in Udmurtiia, Otechestvo won 42 of the 100 seats. In mid 1999 polls showed it to be running at about 15% support nationwide, second only to the Communists.

Its main rival was Vsia Rossiia (All Russia), led by Tatar President Mintimier Shaimiev. Vsia Rossiia was founded on 22 April 1999 at a meeting in Moscow (attended by Luzhkov) and led by Shaimiev, Ingushetiia's Ruslan Aushev, North Osetiia's Aleksandr Dzasokhov, Bashkortostan Murtaza Rakhimov, Astrakhan governor Anatolii Guzhvin, Omsk's Leonid Polezhaev, and St. Petersburg's Vladimir Iakovlev. It included Vladimir Medvedev's Russian Regions group from the State Duma. Its main problem was that it lacked a charismatic leader who could himself become a candidate for president. Shaimiev announced that he was willing to cooperate with Otechestvo up until the State Duma elections in December 1999, in a bid to minimize the Communist presence in the legislature. But the group had radically different views on federalism from Luzhkov, who favors strong centralism.[19] Another important difference was that Vsia Rossiia wanted to scrap the party lists which fill half the seats in the Duma election, which given the weakness of the party system are filled by parties with less than 50% of popular support (most notably the Communists). At least they wanted to change the current legislation, under which candidates who occupy the top three places of a party's federal list cannot run in any of

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18 *Nezavisimaia gazeta,* 13 April 1999.

19 Interview with Fandas Safiullin, leader of "Volga Is Our Home" faction in Tatarstan's assembly, *RFE/RL,* 30 April 1999.

Russia's 225 individual electoral districts.[20] Given Otechestvo's high standing in the polls, Luzhkov was quite happy with the party list system, since this guarantees his party a large bloc of seats in the Duma.

Several other governors have presidential aspirations. Golos Rossii (Voice of Russia) was founded on 17 February 1999 by Samara governor Konstantin Titov. It called for "new federalism," equalizing the differences between the regions and republics, and was opposed to the Moscow-centrism represented by Luzhkov's Otechestvo. When it held its party conference on 21 April 1999, President Yeltsin scheduled a meeting with some governors at the same time, to deter them from attending. Kemerovo Governor Aman Tuleev founded the Vozrozhdenie i edinstvo party (Revival and Unity) on 5 June 1999 in Moscow, with an intention of competing in the parliamentary and presidential elections. The party is supposed to appeal to the dozen or so "red" governors, but none of them participated in the founding congress.

Federal Policy Towards the Regions

The emergence of a coherent development strategy is fatally constrained by the absence of a coherent legal framework for regulating the behavior of federal and regional actors. The Russia Federation is a curious hybrid. According to the constitution (article 77) it is a unitary state, but in practice since 1991 it has evolved into a system based on bilateral power-sharing treaties between federation subjects and the center. To date 46 of the federation's 89 subjects have signed such treaties, which are generally not published and are of dubious legality. According to the regional ministry's 1998 report, 42 of the 46 treaties violated federal laws, as did 236 of the supplementary agreements (soglashenie) which were signed to implement the treaties in specific policy areas.[21]

Russian federalism was shaped by economic managers (khoziaistvenniki) rather than by officials concerned with the rule of law (zakonniki). Essentially, it is based on legal nihilism. Many of the federation subjects either willfully or through omission fail to recognize the priority of federal legislation. 18% of the normative acts passed by regional powers in 1998 violated the federal constitution or other federal legislation (although in 1997 the proportion had been even higher - 30%).[22] 3,000 local acts have been appealed by regional prosecutors, 20 of them have been reviewed by the Constitutional Court. For example, in Moscow and a dozen other oblast' local regulations violate the constitutional right to live where one chooses without requiring permission from

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20 Brian Whitmore, "All power to the provinces?," Jamestown Foundation *Prism*, Vol. 11, No. 3, 4 June 1999.

21 "O khode realizatsii osnovnykh polozhenii regional'noi politiki v Rossiiskoi Federatsii v 1998 godu," Ministry of Regional Policy, 1999.

22 *Ibid.,* p. 5.

the local authorities. Laws in Adygei, Dagestan, and Kabardino-Balkariia illegally limit top elected officials to those with residence for 5-10 years and speaking the local language. At the end of 1998, in the wake of the August crisis half of the federation subjects had introduced illegal laws banning the export of certain types of goods (mainly food). Tatarstan passed a citizenship law on 16 April 1998 which allows residents to be citizens of Tatarstan without being citizens of Russia. On 18 August 1998 Bashkortostan even created its own security service outside the federal FSB. Contrary to the federal constitution there were no legally constituted local government organs in Osetiia, Tyva, Altai, and Komi, and in parts of a dozen other regions.

There are some parts of the Russian Federation over which Moscow exercises very little control - but about which Russia's leaders are not allowed to forget. Chechnia, Dagestan, Ingushetiia, and Kalmykiia are effectively independent of the Russian Federation, and Tatarstan and Bashkortostan are not that far behind. Of particular concern is the spiral of violence in the North Caucasus. Fighting between rival clans has increased in Dagestan in 1998-99, with for example armed groups temporarily took control of the republican administration building on 21 May 1998. Kidnapping became a backbone of the local economy (with many victims spirited over the border into Chechnia). Central interior ministry troops no longer patrol the republic (although the Russian Army does control the border with Azerbaijan). The situation in neighboring Chechnia was even grimmer. Yeltsin's envoy to Chechnia, Valentin Vlasov, was held hostage for six months in 1998. In the wake of the shooting of four policemen on 7 April 1999 Stavropol' governor Aleksandr Chernogorov closed the border with Chechnia: federal interior ministry troops proceeded to create a 15 kilometer buffer zone. A few days later Chechen President Aslan Maskhadov survived his sixth assassination attempt of the year. The only element of normality in the situation was that oil continued to flow through the pipeline across Chechnia (joining Baku to Novorossiisk), with the Chechens receiving $10 million in annual transit fees. A series of explosions ripped through the North Osetiian capital of Vladikavkaz in the spring of 1999, killing 65 people in the market place on 19 March and another five in May.

Controversy erupted in Karachaevo-Cherkessk around the elections for governor in April 1999. The former ground troops commander Vladimir Semenov, an ethnic Karachai, polled 17% while Cherkessk mayor Stanislav Derev, a local businessman and ethnic Cherkes, won 40%. However, the run-off on 12 May was won by Semenov with 75% to Derev's 18%, perhaps because of a strong turnout for Semenov by ethnic Russians, but perhaps because of vote-rigging. This triggered street protests by disgruntled Cherkes. Prime Minister Sergei Stepashin visited the region on 25 May, annulled the election result, and put the Russian speaker of parliament in temporary charge. Some observers saw this as a new and indeed unprecedented policy of decisive intervention in regional affairs.[23]

23 Igor Rotar, "Elections in Karachai-Cherk essia aborted," *Prism*, 4 June 1999.

Overall, national policy towards the regions has been deeply contradictory. On one hand the Kremlin keeps threatening to enforce federal rules and impose a unitary state, on the other hand it continues to pick favorites and steer policy through bilateral treaties. On 17 March 1999, for example, President Shaimiev of Tatarstan signed an agreement with Prime Minister Primakov prolonging for five years the budgetary agreement signed as part of the 1994 power-sharing treaty with that republic.

Federal leverage over the regions rests in large part on its capacity to dole out subsidies. But with federal revenues reduced to 10-12% of GDP, and federal spending programs (on defense for example) already cut to the bone, Moscow has little room for maneuver. The federal government ran only 19 investment programs in 1998, on which it spent less than 1 billion rubles ($200 million).[24] They were just about able to meet the physical deliveries of supplies (but not the financial support) for the 3 million inhabitants of the Far North - 4 million tons of oil, 4 million tons of coal, and 1 million tons of food. During its brief period in office (March-August 1998) the Kirienko administration tried to tighten control over how federal transfers were spent, in recognition of the fact that governors were routinely diverting federal funds to non-designated uses. Cheliabinsk and Khakasiia were persuaded to sign agreements with the federal finance ministry making their relations with the center more transparent, whereas St. Petersburg, Perm, and Krasnoiarsk bluntly refused to comply.

Over the past two years the locus of federal policy-making towards the regions shifted from the presidential administration (Kremlin) to the government (White House). After Yeltsin appointed Viktoriia Mitina in November 1997 to be his regional policy aide, the Kremlin's grip on the regions weakened. Mitina was dismissed after her failure to prevent Lebed's victory in Krasnoiarsk in May 1998. Her successor, former KGB official Vladimir Putin, made a greater effort to rein in the regions. After three months Putin was moved to head the Federal Security Service, and he was replaced by former deputy prime minister and ex-mayor of Samara Oleg Sysuev.

Primakov's government, which took power in September 1998, made some efforts to reach out to the regions. However, previous governments had been able to replenish their ranks through recruiting regional leaders, Primakov was only able to persuade one such official, Leningrad oblast governor Vadim Gustov, to join his government. Eight incumbent regional leaders were invited to join the presidium of the government, a rather empty gesture since the presidium meets infrequently and enjoys little authority. Regional policy was split between the Ministry of Nationality Policies (Ramazan Abdulatipov) and the Ministry of Regional Policies (Valerii Kirpichnikov). Kirpichnikov pursued a policy of reaching over the heads of governors to build support with the mayors and district chiefs (through targeted spending programs for example). Gustov was appointed first deputy prime minister responsible for regional policy, and he

24 *Ibid.*, p. 8.

was seen as an advocate of merging oblasts to create smaller (and hence more manageable) number of federation subjects.[25]

Gustov was fired at the end of April 1999 and replaced as first deputy prime minister by Interior Minister Sergei Stepashin. Stepashin pledged to crack down on criminal elements in regional governments, saying that corruption had been uncovered at deputy governor level in a dozen regions and implicitly accusing procurator Yurii Skuratov of collusion with these elites.[26] Over the course of 1998-99, for the first time since 1992, one saw some senior officials (albeit mostly ex-officials) convicted of corruption. In Tula, Vologda, Kemerovo, and Vladimir former governors were prosecuted on various charges of bribery, while sitting deputy governors were arrested in Tver', Voronezh, and Kursk. On 1 April 1999 the Krasnoiarsk Krai Court found Noril'sk mayor Vasilii Tkachev guilty of taking bribes in form of two cars, and he was sentenced to 8 years.

When Yeltsin nominated Stepashin to replace Primakov as prime minister on 12 May 1999 Stepashin offered a more diplomatic face, addressing the Federation Council to reassure them that he would take regional interests into account. But in interviews he reiterated his commitment to a strong central hand in regional affairs, as befits a career security official.[27] In his administration the two former regional ministries were merged into one, led by Viacheslav Mikhailov. Unlike previous governments, Stepashin's did not recruit a single former governor, although First deputy Prime Minister Nikolai Aksenenko quickly emerged as the champion of regional interests.

A noteworthy change over 1998-99 was an increase in the significance of the Federation Council, although it still remained a relatively weak body (unable for example to prevent Yeltsin from firing Prime Minister Primakov). Its potential as a senate representing all of Russia's regional leaders is countered by the infrequency of its meetings and the sharp divisions of interests between the various provinces (only a dozen of which are net contributors to the federal budget). The first case in which the Federation Council flexed its muscles was its support in July 1997 for Primorskii krai governor Nazdratenko, who successfully resisted President Yeltsin's attempt to dismiss him. Before the August crisis, however, as a collective body the Federation Council was "almost invisible," and in practice still not as powerful as it appeared.[28] It uses its legislative veto only occasionally and very rarely in open confrontation with the president. It became more active after the August crisis, opting to review the draft 1999 budget in parallel to the State Duma, and supporting the latter's proposed 5% cut in VAT.

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25 Jakob Hedenskog, "Will unification strengthen the Russian Federation?," *RRR,* No. 19, 20 May 1999.

26 Interview, NTV, 2 May 1999.

27 Interview in *Komsomol'skaia pravda*, 13 May 1999.

28 Oksana Oracheva, "The role of the Federation Council," paper at Association for Study of Nationalities annual conference, New York, 17 April 1999.

On 17 March the Federation Council stirred from its slumber by refusing to accept the resignation of Procurator- General Yurii Skuratov by 142 votes to 6 - a direct snub to President Yeltsin. Skuratov had been investigating the dealings of Kremlin financier Boris Berezovskii, but was blackmailed into offering his resignation in February under threat of exposure of his sexual misadventures. Skuratov, the country's top legal official, then entered a legal limbo - not allowed to do his job by Yeltsin, who is responsible for appointing the procurator, but not allowed to resign by the Federation Council, who must approve the appointment.

Economic Woes

In the immediate wake of the August crisis regional leaders responded by banning the export of certain goods from their region, introducing controls on prices and retail markups, and even asserting direct control over alcohol production.[29] However, after a few weeks these responses seemed increasingly muted - partly because the feared hyperinflation and economic breakdown never occurred, and partly because price controls and food export bans withered as producers refused to sell to local authorities at their fixed prices.

Social protests were relatively muted, with the country already having experienced a flurry of protests over wage arrears by coal miners in May 1998. The national "day of protest" called by the communists on 7 October 1998 was a meek affair, for example. Lack of vision of an alternative seems to be the major factor dampening social unrest. Surveys show that even though 49% suffered economically from the August crisis those favoring a market economy still outnumber its opponents by 47 to 39%.[30]

As in previous years, wage arrears were the main focus of unrest. The Primakov government made some progress in reducing the backlog of wages owed to workers on regional government payrolls, which fell from 13 billion rubles (or 2.1 months delay) in January to 8.3 billion rubles (1.3 months) in April.[31] Ten regions were reported to have erased wage arrears completely. Still, there were reports of districts using coupons and issuing their own currencies to overcome the liquidity shortage.

Overall the regions were less affected by the August crisis than was Moscow (both the city, the corporations based there, and the federal government), mainly because regional banks had very limited exposure to the GKO market, and because so much of the local economies had become demonetized. Some

29 Vladimir Mironov, "Regional elites and Russia's financial-political crisis, " *Prism*, Vol. 4, No. 20, 16 October 1998.

30 Leontii Byzov and Vladimir Petukhov, "August shook pockets but not heads," *Obshchaia gazeta*, No. 7, February 1999, pp. 18- 24.

31 Intar- Tass, 25 May 1999.

local producers and exporters benefited from a weaker ruble and the disappearance of imported goods from the domestic market.

Many of the regions did default on their foreign and domestic debts, although the cities of Moscow (with more than $2 billion borrowed) and St. Petersburg ($400 million) remained solvent. In November, Moody's gave St. Petersburg a credit rating of B+, while the rest of Russia had to settle for a CCC. Leningrad oblast defaulted on a $50 million syndicated loan in May 1999; and Nizhnii Novgorod failed to pay a $4.4 million 2002 Eurobond coupon that fell due in April. Tatarstan defaulted on a $100 million syndicated loan in November 1998, and the republic's oil company, Tatneft, missed a $13.5 million payment in April 1999 on its $300 million Eurobond.

The new federal budget for 1999 gave regions the right to introduce a new sales tax of up to 5%, with all the proceeds going into regional coffers. By 1 June 1999 71 of the 89 regions had introduced such a tax, although it stirred controversy since it was levied on top of the existing VAT. During the first month it was levied (20 January - 20 February), St. Petersb urg's 5% tax raised 155 million rubles, more than twice the sum collected the previous year from the seven taxes that were cancelled when the sales tax was introduced.[32]

Mayor Yurii Luzhkov fought a protracted battle with the normally complaisant city Duma over establishing a sales tax in Moscow. Luzhkov wanted a 5% tax (which would raise an estimated 6 billion rubles, or $220 million) and twice vetoed a 2% tax proposed by the Duma. On 5 May 1999 the two sides agreed to compromise on 4%, but two weeks later the Duma decided to give local merchants a six month reprieve and charge only 2% from 1 July. Similarly, the Kemerovo oblast assembly on 15 March 1999 repealed the introduction of a 5% sales tax which had come into effect on 1 March. These disputes over the sales tax show that when the federal center gave more power to the regions it did not necessarily lead to an easier life for regional leaders.

Apart from the new sales tax, Russia's long-suffering small businesses were also hit by the implementation from 1 January 1999 of a new federal law on using imputed business income as a basis for tax assessment. (Tax officials estimate the likely income of a certain type of business in a certain location). Such a procedure is standard in the US, to avoid under-reporting of income by small businesses, but given the level of corruption in Russia's State Tax Police one can imagine that it merely introduces another dimension of bureaucratic abuse. In Komi Republic for example half of traders closed down in the first quarter of the year after the tax was introduced 1 January. Tax assessments for Komi market traders in 1999 had increased sixfold over the 1998 level.[33]

32 *Finansovaia gazeta*, regional'nyi vypusk, No. 12, March 1999.
33 *RRR,* No. 14, 15 April 1999.

Privatization in Reverse?

Perhaps the biggest coup for regional leaders on the economic front came before the August crisis, with the passage of a law in April 1998 by the Federation Council and State Duma - overruling Yeltsin's veto - ordering that the state hand over 33% of shares in the electricity monopoly EES to the regional administrations. (Alone among the regions, Tatarstan and Irkutsk had managed to keep their regional energy companies outside the EES altogether.) Although EES was chaired by arch-reformer Anatolii Chubais, he faced a tough struggle in trying to reform the industry in the face of the regional governors who were now to sit on the EES board. However, their chronic inability to meet energy bills means that most regions will still be in a weak relationship vis-a-vis EES. (In 1998, EES introduced a practice of only releasing to customers energy equal to the amount paid for the preceding month.)

The August crash further undermined the profitability of many enterprises, opening the door to re-nationalization as they handed over equity to federal and regional governments in return for forgivance of tax debts. In this manner Rostov oblast gained control of the agricultural machinery giant Rostselmash, while Samara and Nizhnii Novgorod persuaded the federal center to transfer ownership of several large enterprises to the oblast in exchange for forgiving federal debt to the region. Formal share ownership was not always necessary: oblast administrations can manipulate firms through their influence over the court authorities responsible for introducing bankruptcy proceedings. In this manner Cheliabinsk governor Petr Sumin announced in April 1999 that he was exercising "political protection" over 200 local firms, including the Cheliabinsk Tractor Factory and Ural Aluminum Works.[34] In May Orenburg governor Vladimir Elagin was able to block the inclusion of the local oil producer ONAKO (which accounts for one quarter of the oblast revenue) in the state oil company Rosneft', which was being prepared for privatization.

Some reprivatization was putting assets back into the hands of the federal government. The Volzhskii Auto Factory reached agreement with the federal authorities under which it will repay its 12 billion ruble state tax debt over 10 years, while giving the state shares with a nominal value of 16 billion rubles as collateral.[35] Thus the overall impact of the August crisis is to further muddy the waters of corporate governance in Russia, blurring the distinction between public and private and making the emergence of a transparent and competitive market economy a yet more distant prospect.

Foreign Investors Wary

The August crisis wiped out the holdings of indirect and portfolio investors in the Russian market. Those who did not have the foresight to cash out in

34 *RRR,* No. 15, 21 April 1999.

35 *Kommersant Daily*, 1 June 1999.

June and July 1998 will be lucky to get 5 cents on the dollar of their investments. Such a record will be a deterrent to future lending.

The subsequent recession and increased difficulties with moving money in and out of the country also caused many Western firms to scale back their direct investments in Russia. According to the Chinese proverb crisis brings opportunity, but in Russia it seems to bring only crisis. Foreign direct investment, already anemic at about $2 billion a year, is likely to shrink in the immediate future. Western bankers are sensitive to criticism that their previous lending was too focussed on the Moscow-based oligarchs. In May for example the European Bank for Reconstruction and Development announced that its Russian Bank of Project Financing would open branches in St. Petersburg, Nizhnii Novgorod, Omsk, Ekaterinburg, Samara, and Toliatti. But there is little sign that the private sector will be following their charge.[36]

In an Economist Intelligence Unit survey of 75 Western firms in May 1999, 46% of those surveyed said their sales had fallen since the August crisis, by 35-50%.[37] Sixty percent had suspended and one third had cancelled new investment plans. 65% had cut their Russian staff and 40% had cut pay. On the other hand, one third expected to expand sales - presumably taking adv antage of the post-August fall in domestic production costs compared to imported goods. In Leningrad region for example Phillip Morris's $330 million cigarette facility was going ahead, as were $40-50 million plants being built for Gillette, Wrigleys, and Caterpillar.[38] But some flagship operations were to close, such as Pizza Hut and Dunkin Donuts. Holland's Philips sold the Voronezh television tube factory to the oblast administration for 1 ruble in March 1999. Philips had bought the plant for $2 million in 1995 and invested $61 million therein, but could not compete with imported TVs and had a series of feuds with the local authorities over tax and debt liabilities.

Take for example the auto industry, which is sorely in need of massive reinvestment. VW/Skoda postponed a planned factory in Udmurtiia, while Fiat delayed their $850 million plan for Nizhnii Novgorod. These foreign partners planned to lobby the Russian government to extend their tax holidays from five to seven years. The General Motors joint venture at Elabuga in Tatarstan stopped assembling Chevy Blazers (even after two years, it was producing less than 2,000 units a year) The one positive piece of news was BMW's announcement that it was planning a $50 million assembly project in Kaliningrad's Yantar' shipyard. One should also note the start of assembly of Daewoo autos at a $270 million facility in Taganrog in September 1998.

The oil industry, which was still in process of corporate restructuring in mid-1998, saw some of its leading new firms thrown into chaos by the August

36 Vremia MN, 14 May 1999.

37 Reuters, 1 June 1999.

38 Neela Baneerjee, "Economic crisis not scaring some companies out of Russia," *New York Times*, 1 May 1999.

crash. They had borrowed heavily in dollars to finance their expansion and the collapse of the ruble plus the slump in world oil prices left them unable to meet their repayments. Menatep Bank lost control over Yukos oil company when it defaulted on a $236 million loan backed with Yukos shares. As a result Germany's state-owned Westdeutsche Landesbank acquired a 15% stake in Yukos and Daiwa Bank a 14% stake.[39] The financial squeeze also enabled the government to reassert some greater control over the industry's taxes and pipeline fee regime.[40]

A battle royal was raging for control of fourth-largest oil company Sidanko. BP-Amoco had bought a 10% stake in Sidanko for $571 million in 1997, but 40% of the firm was acquired by banker Vladimir Potanin's Interros group. Potanin lost control of Sidanko in a shareholders meeting in April 1999, but an 18 May court decision to put the company into receivership prevented BP-Amoco, which by then held 20% of Sidnako shares, from gaining control. (It is interesting to see the bankruptcy mechanism, much touted by Western advisors, being used to block pro-market forces.)

Almost the only positive news on the oil front was the announcement in May of a $200 million loan guarantee from the US Eximbank to Tiumen' oil company to retool its Riazan refinery. (This was perhaps connected to fact that Tiumen' NK had recently signed up Coca Cola as the sole distributor of soft drinks at the company's 540 gas stations.)

Conclusion

Is there a realistic chance for a Girondist alternative in Russia - a decentralized, bottom-up reform process to replace the top-down shock therapy approach? There are several grounds for believing that decentralization per se will not fill the institutional vacuum that has been one of the core problems facing the Russian transition.

First, the "democratic deficit" at regional level is just as acute if not more acute than at national level. Just because regional rulers are physically closer to the citizens than national rulers does not necessarily mean that they will be more responsive. We live in a post-Rousseau world, where wealth is generated, stored and consumed on a national and global scale. Only political mechanisms at national level can stand a chance of checking the abuse of power. Opposition forces at regional level are weak and fragmented. The experience of the Mediterranean countries which made the transition from authoritarian to democratic rule in the 1970-80s suggests that it takes 10-15 years for regional parties to crystallize - and that is under much more favorable conditions for democratic consolidation.

Second, the fact that decentralization has preceded the consolidation of rule of law at national level is a recipe for trouble. A limited role for the center

39 *Wall Street Journal*, 31 May 1999.

40 Sergei Kolchin, "Russia's oil companies and taxes," *Prism*, Vol. 5, No. 1, 15 January 1999.

can work only if the center is able to lay down general rules which the regions will follow. In the absence of rule of law, devolution will lead to "neomedievalism" - the emergence of a mosaic of distinct sovereign powers on the territory of the state.

A recent forecasting exercise by specialists in the European Union produced a consensus that radical change in Russia in the near future is highly improbable.[41] This included both a dramatic breakthrough to an efficiently functioning market economy, on one end of the possible spectrum of developments, and apocalyptic scenarios, such as a collapse of the economy, a military coup, or the break-up of the federation along regional/republican lines, on the other. Western policy towards Russia will have to recognize the need to deal with a pluralism of actors, both regional and central, economic and political, and in both the private and the public sectors. Within that mosaic they will have to concentrate their efforts on "islands of change" rather than squandering their resources in a bid to achieve systemic transformation. Russia desperately needs foreign assistance in technology, capital, and ideas for how to run a modern society, but it lacks the basic structures required to use such assistance effectively.

41 *Russia's Futures: The EU's Long-term Strategy in Russia*, Interim Report, Conflict Prevention Network Briefing Paper, Brussels, June 1999.