THE ROLE OF THE STATE IN INDUSTRIAL RESTRUCTURING

Yuri Khromov

Head, Economics Department
Russia's Institute for Strategic Studies, Moscow

One of the results of economic transformation in Russia in the 1990s is the real threat of de-industrialisation and the complete disappearance of certain industries. In the former USSR, Russian industry was based on the military-industrial complex which was entirely in the hands of the state. The inflow of petro-dollars in the 1970s and 1980s went on the modernisation of these military-oriented industries. More recently, export revenues from the sale of oil, gas and metals are spent on financial speculation and on credits to import consumer goods and food. The strategic goal of economic policy in Russia for the 21st Century is the modernisation of industry that is capable of guaranteeing economic growth. The development of the fuel and energy complex should become a means of maintaining a sound financial background to foster industrial growth in Russia.

It is not an easy task to analyse the role of the state in Russian industry since, according to Professor Wally Struys, "the victory of market over state is taken for granted". It is also a fact that the Russian government has only recently begun to realise that "pure market economies without any state intervention do not exist and never will exist" (Wally Struys). Until 1997-1998 the Russian government was preoccupied with systemic changes to economic structures and with financial stability. When this was at last achieved in 1997 - assuming the Asian financial crisis does not "spoil the game" - the next step of governmental economic strategy should be the promotion of industrial restructuring and economic growth.[1]

The present state of industrial production represents a phase of stabilisation. However, this is at a low level appropriate to about 45-50% of the volume of industrial production in 1990. GDP in Russia increased by 0.4% in 1997 in real terms. This was the first growth in the economy achieved following five years of recession (1992-1996). Industrial production increased by 1.9%. In the few sectors where there was no growth, signs of stabilisation were obvious - in food processing and the production of construction materials amongst others.

Table 1: Russian Industry Output Indexes
(% change from previous year)

	1996	1997
Industry, total	**96.0**	**101.9**
Electric power	98.4	97.9
Fuels	98.5	100.3
Metallurgy	97.5	101.2
Chemicals	91.9	102.0
Machine-building	95.3	103.5
Wood and pulps production	82.5	101.2
Construction materials	82.7	96.0
Light industries (textiles, etc.)	77.5	97.6
Food processing	95.8	99.2
Microbiological production	80.0	106.1
Medicine production	103.5	115.1

Economist. Russian Ministry of Economy, Moscow, 1998, March, p. 28.

The fact is that the state does not have the means to support all industries in Russia. Industrial policy should be differentiated concerning separate manufactures and branches. In industrial policy there could be three strategies: 1) use of natural resources; 2) "strategy of pursuit", i.e. the modernisation of traditional manufacturing; 3) strategy "of advanced boundaries" - the creation of new technologies and new products. None of these strategies could be applied at once to the whole of Russian industry. But each of the three could be applied to separate sectors of Russian industry. Russia would continue to use natural resources and to develop primary industry. Concerning the majority of branches, the "strategy of pursuit" will be applied. The strategy "of advanced boundaries" is applicable to the manufacture of armaments, aviation and space, and the nuclear industry.

At the end of 1996 the Russian government adopted the "concept of industrial policy until the year 2010". The whole of industry is divided into three sectors. The first includes fuels, energy and raw material production capable of surviving and developing independently, whilst attracting private investment. This sector would not need direct help or intervention from the state. The role of the government would be to create an appropriate tax system. As Professor Struys points out, "regulating and preventive interventions" are all that is needed in such sectors of industry.

The second sector consists of "high-tech": nuclear power, space technologies, armaments, aviation, power mechanical engineering, special metallurgy and biotechnology. In this sphere, state procurement and stimulation of exports are welcome. Financial support will be carried out in the form of investment grants

and export credits. The government will render support first of all to competitive enterprises which could become a driving force of a revitalised Russian industry.

The third industrial sector consists of diverse branches that technologically are far behind western analogues. The survival of such industry is economically and socially important in that it creates new jobs and increases supply on the home market. In this sector it is highly necessary to import technologies under the protection of selective customs duties, import quotas and other protective measures that correspond to WTO rules. This group includes: automobile industry, transport, road and agricultural machines, mechanical engineering, textiles, and the food-processing industry. Public funds for the development of promising enterprises should be given out only for real projects with the appropriate guarantees and with rigid control over the use of such funds.

For each branch there will be programmes of enterprise restructuring, such as has been achieved in the coal industry. Unfortunately, unemployment would grow. But migration of manpower is a characteristic, indeed inevitable, feature of structural reorganisation. To mitigate this situation, a whole complex of measures need to be undertaken: training of workers, public works, and so on.

This is a hard period of transition for Russian industry. The problems of industrial modernisation which Russia now faces are not dissimilar to the economic challenges faced in the epoch of Peter the Great or in the 1930s. As the former Economics Minister, Eugeniy Yasin, has stated, “Russian industry needs investment until 2015 of US$2,800bn, two-thirds of which should be Russian sources. Financial inflows are needed to improve the liquidity of industrial enterprises, to buy new equipment, to fund export credits, to improve labour productivity and to support private investment. The export of mechanical engineering goods is potentially one means of boosting Russian industry. At present, this sector accounts for 9.4% of total export volumes: in 1985 the share was 22%.

Yet the biggest problem of all remains the reluctance of banks and financial pyramids to lend to manufacturing. The strengthening of the rouble and low inflation have been bought at the cost of industrial recession. But even with low inflation, bankers give few credits to industry or to the so-called “real sector” of the economy.

Professor Wally Struys raised a good question - whether defence industry behaves in the same way as other sectors of the market economy. My answer is dual - “yes” and “no”. No - because defence industry is still more in the hands of the state than any other branch of industry. Professor Struys is completely correct when he says that “an armaments producer can only show his initiative within the limits set by his client”, and that markets “operate in a limited *monopsony* or even *bilateral monopoly*”. Of course, in national arms markets there is nowadays zero perfect competition. On an international scale, competition only occurs before a contract is won. Thereafter, a kind of “planned manufacture” takes place.

But my answer is also “yes” because defence industry in Russia is largely deprived of state support. In 1996, the programmes of research and design work received only 18 to 24% of the planned budget finance. In 1996, not one of 250 programmes of conversion began, programmes that could have supplied the market with essential civil goods and created more than 700,000 new jobs. The reason for the failure - a lack of finance caused by the budget deficit. Nevertheless, receipts from the defence industry in the budget manage to be carried out as a result of the sale of superfluous buildings, industrial areas and military equipment which has lain in warehouses since 1992-1993. The defence industry in Russia has not found its place in the new economic conditions. Efforts, not only financial but also organisational, are now necessary. The first wave of Russian reformers tried, in vain, to convert defence industry by “shock therapy” methods. But the industry was devastated with only a small portion of it having been converted directly. Many sectors of the defence industry should now be regarded in the context of overall industrial policy in Russia. High-tech military technologies lay within the framework of the industrial strategy “of advanced boundaries”.

The former methods of support for an industry (in a market environment) were directed first of all on retarding the fall in output at separate enterprises. Attempts at restructuring were not actually undertaken. Nowadays in Russian industry there is qualitatively another situation in that the volume of production has stabilised. Industrial policy should be directed towards the preparation of “strategic manoeuvre” - stimulation of positive shifts in industries and support of manufactures. The main goal of industrial policy in Russia is to achieve an increase in efficiency and competitiveness of production for both external and home markets. During the next 2-3 years, the best priority should be given to competitive innovation projects. The state could take part in their realisation on a share basis with private investors. The export of goods with a high degree of processing, first of all machines and equipment, should become an element of a Long-Term External Economic Strategy.

Russia is compelled to take into account adverse developments in the market for primary resources which form the basis of Russian exports. Already there has been a sharp fall in international oil prices that cannot but have negative consequences both for payment balance and for the budget. As a result, prospects of the revival of Russian industry could be postponed. In the long-term, the gap between the prices of “high-tech” products and of resources will grow further. This fact alone is a solid argument in favour of the strategy “of advanced boundaries”.

The priorities of industrial policy in Russia for the next 10 years should include:

- modernisation of the economy on the basis of advanced technologies,
- industrial exports,
- high-tech manufacturing,
- safeguard scientific potential,

- strengthening the national industrial infrastructure,
- basic systems of life-support, logistics and safety.

The priorities of the state regarding industrial restructuring should be:

- direct and non-direct support of federal target programmes,
- state purchases of goods and services,
- granting of federal and municipal property in leasing and rent on favourable terms,
- granting of state guarantees to investors,
- assistance with the creation of "Financial-Industrial Groups" (Russian version of TNCs) and other forms of integration of bank and industrial capital,
- stimulation of the development of techno-parks,
- stimulation of export of products with a high degree of processing.

Reform in Russia has not yet given an impetus to the modernisation of industry. Russia has 12% of world scientists and about 25% of global mineral resources, but less than 1% of "high-tech" manufacturing. A strategic role for the state in industrial restructuring is to correct such an imbalance.

Note

1. This paper was of course drafted prior to the Russian financial crisis of August and September 1998. (Editor's comment.)