

Primakov Reforms: They *Should* Do the Trick

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Prime Minister Yevgeny Primakov is much respected as a statesman and consensus builder. But some, mainly former ministers appointed then dismissed by President Boris Yeltsin, have criticized him for “stopping reform” and “doing nothing” in the economic sphere. These criticisms are far from true.

Since his appointment in mid-September, Primakov and his economic team have initiated two major economic reforms that previous cabinets have avoided or failed to implement. They are in the process of simplifying and reducing taxes as well as restructuring or realigning Russia’s banking system in accordance with the principles of modern market economies. In the initial stages of development, it is far too early to expect results from these reform efforts. In the context of an extremely precarious economic and financial situation together with default and devaluation inherited from the Kiriyenko cabinet, it also seems unfair to criticize Primakov for stalling.

Tax reform has proved most controversial. Stanley Fischer from the International Monetary Fund (IMF) and our domestic opponents have called the proposed tax reductions untimely, even disastrous. To lower taxes, they argue, would further reduce government revenues and lead to an enormous deficit financed largely by printing more money, the result of which would lead to hyperinflation. But the Primakov team disagrees, believing tax reductions would encourage firms to pay taxes in full and induce enterprises to produce more goods thus increasing the real tax base.

Theoretically, Primakov’s critics would be correct if the supply side was unchangeable and not positively affected by tax reductions. They claim similar tax relaxation efforts in the past have not resulted in larger output. Such reductions in recent years have been coupled with drastic cuts in federal expenditures, leading to falling aggregate demand. When aggregate demand falls, real GDP is not supposed to rise. Tax reductions lead to worse tax collection.

Mindful of the highly unstable financial situation, the Primakov Government in 1999 is planning to increase federal expenditures, albeit cautiously when measured in real terms. Increases in aggregate demand are limited to the regular payment on time of pensions and wages of federal employees, both civilian and in the army as well as to financing crucial investment projects that will result in fast increases in output. The positive effect of these stimuli combined with tax reductions is expected to bring about general economic recovery by the second half of 1999—in time to influence voters on the eve of the December 1999 parliamentary elections and the presidential elections that would normally be held in June 2000.

Whether these plans materialize depends on the ability of the Government and the Central Bank to restrain inflation and keep the ruble exchange rate from undue devaluation. The Government’s target for 1999 is a maximum consumer price inflation of 30 percent. This would be a definite improvement over the 73 percent upsurge in prices between December 1997 and December 1998. Apart from maintaining relative balance between aggregate supply and demand through fiscal policies, it would also necessitate keeping money supply in check. There are many factors feeding into the Russian money supply equation, and printing money to finance part of the budget deficit is only one element in the overall picture. In an economy that is striving to eliminate barter by restructuring its barter by restructuring its banking system, the process of remonetization would lead to a steep rise in money supply that would not necessarily be inflationary but would in fact help increase tax revenues.

Another important factor is the issue of government indebtedness. The pyramid of short-term treasury bills has ceased to be a decisive factor in the budget picture after the August, 1998 default. But the much larger sovereign debt of the former Soviet Union remains a problem as well as the new debt to the IMF that appeared in recent years. These have become major destabilizing factors. In the current situation, Russia is not in a position to honor all these debts that have to be rescheduled. Because the IMF is partly responsible for the misguided policies of the previous Russian cabinets, it should take a more realistic attitude toward these matters. Admitting past errors would not be pleasant, but it would be better than continuing to err.

On the whole, the chances that the Primakov reforms will work are fairly high. But more understanding is needed from the international community. Supporting the present Russian Government today means insuring against the risk of dictatorship and militarization if its efforts fail. Such dangers are real.

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