

RECOMMENDATIONS FOR THE GOVERNMENT

The Solutions are Microeconomic

Russian citizens are not the only who are greatly concerned about the present economical situation in Russia. Victor Politis, the President of an American company "Private Resources for Industry Inc.", engaged in developing significant investment projects in our country, has decided to give some recommendations to our Government.

- **USA,** the European Union and international financial institutions failed to help reform the Russian economy and prevent the country from sliding into crisis because they concentrated on broad macroeconomic policies rather than microeconomic reforms. History demonstrates that the foundation for growth and stability in market-based economies is a thriving sector of small and medium sized companies. Strategic investors must be allowed to purchase majority stakes in enterprises. They must also be able to make the necessary management changes and hold management accountable for its actions. My advice to Russia's new government is

First: Force domestic banks to sell their industrial assets, which in most cases they failed to manage profitably. Replace crony managers with independent, profit driven management teams.

The world watched as many Russia's banks sucked the life out of the nation's industry for their own financial gain. Now, while the banks are reeling from their own indiscretions, these mismanaged and unstructured industrial companies should be broken up and spun off via a new privatization program as soon as possible. This is the key to attracting strategic investment, spurring job growth and creating new sources of corporate and income tax revenues.

Second: Institute a proper incentive system for management teams. If managers are going to be held accountable for the success of companies, they must see a link between company performance and personal compensation. The incentive system must be changed to encourage profitable development while discouraging stealing from businesses. Good results must be tied to professional and financial rewards, while poor results must have negative consequences.

Third: Target key industries for industrial development.

Trading activity over the last eight years resulted in capital flight and the creation of a thin rank of wealthy individuals with offshore holdings, much to the detriment of the rest of Russian society. Russia must chose sectors in which demand is ever present, such as textiles and food processing, and provide incentives for foreign investment in fixed capital formation in these industries while taking steps to discourage imports. Strategic investors should be encouraged to channel resources into locally staffed and managed, integrated production facilities rather than allow traders and speculators to function unchecked.

Fourth: Stop the pillaging of Russia's natural resources. While bankers were robbing Russia's industries and importers were stealing from average consumers, a small group of individuals was stripping the country of its natural resources and depositing the money in personal off shore accounts. Today, global commodity price swings are a leading short-term cause of the present crisis. To correct this situation, Russia must decrease its reliance upon exported raw materials as a source of foreign exchange and instead promote investment in value-added, down-stream processing facilities. This will help stop the pillaging of Russia's natural resources and the resulting capital flight. This action will also create new jobs and expand Russia's tax base. Exporting value added products will actually increase Russia's ability to generate hard currency revenues, while eliminating current expenditures for imported refined oil products and other commodities.

Since 1991, the architects of Russia's reforms have been confronted by a multitude of difficult choices. From the beginning, it was obvious that each reform would require painful sacrifices. What was not so obvious in 1991 was how fragmentary and ineffective many of the reforms would be almost a decade later.

Implementing and carrying through microeconomic reform will prove painful to those who have benefited most from the previous reforms because it takes longer and removes the opportunity for abuse. Long-term microeconomic reforms will require more creativity and expertise because they are not band-aid solutions. They are, however, inevitable. If Russia is to successfully emerge from its current crisis and develop an economy based on market principles, it must undertake microeconomic reform.