Market reform in Russia brings "dire economic situation"

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A report by the global management consultant firm McKinsey has highlighted the devastating economic collapse which has taken place in Russia since the introduction of "market reform" and privatisation in 1992.

The report, issued last month, describes Russia as being in a "dire economic situation".

When the Soviet Union collapsed at the beginning of this decade its demise was hailed as irrefutable proof of the historical superiority of capitalism. Not only had the "free market" won the great ideological battle of the 20th century, it would now be able to work its "magic" on the territory of the former USSR.

In the light of these assertions, it would be an interesting exercise to compare the economic advances made in the period from 1917 to 1927 with the results of the past decade. Together with the recent UN Human Development report on the former Soviet republics, the McKinsey report, which examines 10 key industries, provides a sweeping indictment of the "free market" program.

"Market reforms," it states, "so far have failed to improve Russia's economic performance. Although the efficiency (productivity) with which companies produced goods and services in the Soviet times was already low compared to the best practice in the world, it has gotten worse since the reforms started."

Gross domestic product (GDP) per capita has fallen by as much as 40 percent since 1992 and is now only 15 percent of the US level. Unemployment is officially at 12 percent with "many more people ... now engaged in subsistence forms of employment."

"The investment picture," the report notes, "is even more dramatic; during the same period, business investment dropped by around 60 percent and is now less than 13 percent of GDP, with very little foreign direct investment."

This latter statistic is a refutation of claims that the introduction of the market would see an inflow of investment.

The McKinsey report found that in the ten industries examined—software, steel, general merchandise and food retailing, hotels, oil, housing construction, cement, confectionery and dairy—overall labour productivity was "very low," averaging only 19 percent of US levels. The highest was software at 38 percent and the lowest cement at just 7 percent.

The fact that the report has been prepared by advocates of "market reforms" adds weight to some of its findings on their impact.

For example, it notes that while what it calls "Soviet legacy assets" were roughly 30 percent as productive as US assets in 1992, they have had their productivity almost halved since then.

Furthermore, assets added since 1992 are "surprisingly unproductive" with "almost no new capacity [being] added in the oil and consumer goods industries, the sectors of the economy with the greatest potential for fast performance improvement."

While labour productivity in the old assets—those put in place before 1992—declined from 30 percent to 17 percent of the US level, this decline has not been compensated for "by a rapid growth of a new and productive economy". "New assets (put in place since 1992) employ less than 10 percent of the Russian workforce and surprisingly, achieve only 30 percent of the US productivity level on average."

According to the proponents of the market, the solution to all problems of productivity is increased competition, and this is the opinion of the report's authors. But as they acknowledge in the Russian situation despite "high competitive intensity," the competition is unequal and actually leads to low productivity. "Price decontrol did successfully stimulate competition. Paradoxically, however, in Russia the more productive firms are often the least profitable."

The report also provides a refutation of the claim by the most fervent proponents of "market reform" that Soviet industry was so backward that its only future was the scrap heap.

There is no question that decades of Stalinist bureaucratic mismanagement and the distortions produced by isolation from the international division of labour—itself a consequence of the Stalinist program of "socialism in one country"—resulted in considerable technological backwardness.

But even with this historical legacy, the report found that "about 75 percent of Russia's inherited assets (put in place before 1992) would still be viable if upgraded and managed according to modern principles." Such an upgrade would allow production in these assets to increase by about 40 percent on average for a relatively small investment of around 5 percent of GDP for five years and could achieve up to 65 percent of US productivity.

But the methods advocated by McKinsey and other proponents of "market reform" to bring about such an advance amount to more of the same policies which have resulted in the economic disaster in the first place.

The theme running through the report is that less productive sections of industry should be shut down in favour of the more productive, a more "level playing field" should be established in the market through the abolition of subsidies and that Russia needs to follow more closely the Polish model.

While such policies may increase the opportunities for profit, they are hardly a prescription for social and economic advance as the social crisis in Poland demonstrates. In the mining and metal industries alone more than 120,000 workers are facing layoff as part of the program to prepare the Polish economy for entry into the European Union while in the countryside unemployment is running as high as 60 percent.

While the McKinsey report concentrated on the situation in industry, it had some pertinent comments on the broader economy. It noted that lack of trust in both the ruble and the banks "deters people from making their savings available for subsequent lending by the banks" and that savings are mostly kept at home in dollar notes. Barter relations are prevalent in about half the economy, involving transactions between industrial concerns and between industry and the government.

And it warned that the apparent recent revival in the finances of the government "should be little cause for comfort."

"Around 40 percent of budget revenues still depend on extremely volatile oil and gas prices, which have fortunately soared in 1999. ... Capital flight, rational when economic policies discourage investment within Russia, continues. Finally, the rise in industrial production, which followed the August 1998 devaluation, should be seen as a one-time adjustment due to a sudden rise in prices of imports, rather than the start of a prolonged economic recovery."