
Part III: Development Plans for the Russian Far East, Northeast China, North Korea, and Mongolia

4 Economic Development of the Russian Far East: Plans and Reality

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PLANS

For decades the former Soviet Government has declared the importance of the Far Eastern region for the political and economic presence of the USSR in the Pacific region. Both Party and Government have tried to realize four special programs to promote the social and economic development of this region.

The first program was in the early 1930s, when the war between the USSR and Japan seemed to be quite real. The second was at the end of the 1960s and the beginning of the 1970s when the Soviet—China confrontation became one of the more important factors in the decision-making process. The third program occurred in the middle of the 1980s when “BAM” began. And the fourth was in 1987 when Gorbachev decided to demonstrate his policy to turn to the East.

None of the programs was successful. All programs were based on the same background—the converting of the Far East into a provincial source of raw materials by imposing a mono-product economy, by pumping the natural resource revenues into the budgets of the State, Ministries, and Departments (all of those that monopolized

control of the regional natural resources), and by financing the social and infrastructural programs on the basis of the so-called principle of the "remainder." It was this policy that exhausted the traditional resource potential of the Far East and, in the end, has brought the area to a crisis in the economic and social spheres. For 1980—1988 period alone, the share of extractive industries in the Far East grew from 24.6 percent to 28.5 percent. The resource base for the region's economic development has been substantially transformed, and in order to maintain the output in resource-based industries, especially for the economic development on their basis, it was necessary to increase dramatically the current capital cost per unit of final products. This has involved introduction of new technologies and technical systems adequate to qualify new characteristics of resources and the conditions for their development along with the increased role of infrastructural factors, initially energy and transport, in the development of the resource sector and with an emphasis on the environmental component in expenditures on raw materials.

The symptoms of the evident crisis, which became manifested in the Far East in the latter half of the 1970s because of the transformed potential of raw materials and the incapability of the centralized planning and management to cope with the situation by means of traditional methods, were overlooked and worsened the situation by the early 1980s. The Long Term State Program for Economic and Social Development of the Far Eastern Economic Region and Transbaikalya for the period to the year of 2000, which was adopted in August 1987, was the last effort to correct the problem by centrally administering the rationing of capital investments and their structural reorientation in favor of the social sphere.

Over the period from 1986 to 1990, the growth of industrial production in the Far Eastern economic region increased to 14.9 percent, less than the 21 percent increase envisioned by the Long Term Program and the 17.5 percent according to the primary 5-year plan. But even this level was achieved only due to the 5 percent increase in 1986 in industrial production.

Although the Program enjoyed State status and 200 billion rubles of capital investments were to be allocated from the centrally administered resources, the region has begun experiencing restrictions in capital investments since 1986, and for all that, the ministries and departments concerned practically avoided responsibility for this program under the pretext of transition to the market economy and *khozraschety* autonomy given to the enterprises. In fact, the region itself did not possess any resources to finance productive infrastructure and social programs. According to estimates, even if the rates of the region's economic development during the period 1991—1995 could be maintained at the level envisioned by the Long Term Program (annual average 6.3 percent), the deficit of capital investments in the Far Eastern economic region alone would total at least 25 billion rubles. But, as seen earlier, the region cannot rely on centrally administered financial resources and has no opportunity to increase locally accumulated resources at the expense of business activities.

Moreover, this region has become the market of foodstuffs and consumer goods, and that market is increasingly being ruined by the processes in the country at large. Naturalized economic ties between the enterprises and between the regions, agreements on contract prices, and the fixed prices on raw materials have resulted in the

unfavorable situation for the Far Eastern region. A much higher share of the regional extractive industries, compared to those in the heartland of the country, and heavy dependence on inter-regional exchange (at least 50 percent of the gross national product of the region is in import and export circulation) make the region unable to finance the needed supply of goods and force it to resort to naturalized exchange as locally produced raw materials are not the region's property.

In 1991, the situation changed so that it was clear to everyone that The Long Term Program would not be realized. It was the end of the Plans Era in the field of the Far Eastern economic development. Everyone thought that nothing could be accomplished. But the end of one Era became the beginning of other.

DREAMS

Governmental plans changed regarding regional desires. In 1991, the Russian Government was occupied with the struggle with the USSR Government, even as the Russian Soviet was occupied with the struggle with the USSR Supreme Soviet. The highest Russian officials had only one goal—to show that all USSR officials, organizations, and decisions were inadequate and that the Russian Government and the Supreme Soviet were the only defenders of the regions. This is why the Russian Government encouraged Far Easterners to create their own program oriented on market economy and promised its support and help.

Instead of implementing a policy imposed by the center without due regard for the region's needs, the Far Easterners have defined their own policy of economic development and international cooperation that can be realized provided there are guarantees on the part of the Government. Such "policy from the Center" has already resulted in the failure of the housing program, a relatively low level of personal income for the population in the region as compared to the other areas in the country, a market hungry for most commodities, and the rationing of foodstuffs and industrial goods. And all this against the backdrop of flourishing neighbors—Japan, the Republic of Korea, China, Taiwan, and Hong Kong—countries that are far from being rich in natural resources. The Far Easterners have lost their faith in traditional plans and programs of any kind whose implementation is under the complete control of ministries and governmental agencies, and whose allotted resources are dissolved in "the common boiler."

An alternative policy of development must be aimed to increasingly promote the market economy of a mixed type granting equal rights to all economic units, able to encourage flexible business activities, and to be mostly open for cooperation with the Asia—Pacific countries. Modernization policy with regard to the Russian Far East should proceed from two basic principles.

First, the region's economic resources must be the basis for economic development. Their utilization should be strictly linked to commercial expediency with due consideration on the region's environmental and economic restrictions.

Second, the region's economic development should be oriented towards strong and deep economic ties with the nations of the Asia—Pacific region not only in the form of commodity trade but also through the exchange of technologies, capital, and activities.

An essential element of this policy geared toward achieving such results is the legal right to flexible taxation, the regulation of custom duties, currency exchange, the operation of banks, and other measures discussed below to secure the market and lively business activities.

Incentives for Investments and Entrepreneurs' Activities

Preferential taxation terms

- A 3-year deferment in payment of profits tax would be granted to all enterprises after they received the declared profit. With regard to foreign companies and joint ventures the deferred payment would be granted for 5 years.
- The total revenue tax would account for about 20 percent; the enterprises of advanced technologies and enterprises producing a large share of export-oriented goods would be granted preferential taxes at the sum of 50 percent of the total taxation.
- Within the first 5 years of operation, the remittances of foreign and mixed enterprises' revenues as well as the incomes of employed foreign staff would be tax free.
- The foreign enterprises and joint ventures in the region would be tax free on the share of the declared revenue aimed toward financing social and productive infrastructure, and would be allowed to reinvest a share of the revenue, provided reinvestment would be done at least for three consecutive years.
- A speedy amortization of the fixed capital would be allowed to all enterprises in the region. The sinking fund would remain completely at the disposal of an enterprise.
- Expenditures on capital investments to modernize production, develop new technologies and technical systems into production, and to develop the region's social and cultural spheres would be exempt from the revenue that is to be taxed.

Preferential financial rates

- All foreign enterprises and joint ventures as well as the Soviet enterprises in the field of exports would be granted the right to convert assets in rubles into a foreign currency as per the commercial exchange through the Far Eastern Bank of Economic Development.

Both foreign enterprises and joint ventures in the region and Soviet enterprises within the first 5 years of operation would be granted preferential rates on rental payments of all kinds, such as for land, buildings and facilities, water, energy, communication, and for other public services.

Organizational privileges

- More simple rules to register foreign enterprises and joint ventures in the region would be set up by the decision of local governments upon examination by experts.

- The Soviet state-owned enterprises would be secured the right to set up joint ventures independent of the higher authorities in compliance with the conventional rules to register foreign enterprises in the region.
- All economic units would be granted the right to carry out commodity exchange and intermediary operations on goods and services produced within the region.
- All economic units would follow the uniform business bookkeeping accountability on the basis of foreign standards and technique.
- A commodity exchange would be organized to procure the needed raw materials; the exchange uses the trade intermediary organization and firms to carry out direct procurement of raw materials, equipment, and components outside the region on contractual terms.
- Joint and foreign enterprises in the region would be granted the right to carry out foreign trade transactions without a license; the Soviet enterprises and organizations would be required to get a license for the same transactions. The local governments would be delegated the right to deliver licenses in all occasions except for restrictions on trade-economic relations imposed by an authorized agency of the Central power due to military—political considerations.

Preferential custom duties

- No duty on imports and exports of goods and services produced in the region or designed for productive and consumer goals outside the region.
- Deferred and reduced duties on goods and services produced in the region and imported to the national domestic market at a sum equivalent to the cost of an imported component of these goods and services.
- No duty on goods and services in transit through the region from the inland of the country, excluding a sum equivalent to the cost added within the territory of the Far Eastern region and Transbaikalya (in the case of final operations on production, packaging, etc., within the region).

Reorganization of the Financial System

The basis for a new financial system would be the institutionalized Far Eastern Bank of Economic Development (FEBED) as well as a network of commercial banks and branches of foreign banks. The FEBED would function as a commercial bank but would also be closely related to the National State Bank and the State Bank of the RSFSR.

The FEBED would partially provide the convertibility of ruble deposits corresponding with the economic activity inside the region on the basis of export operations and define the exact ruble rate in regard to foreign currencies. In the region's territory it would be necessary to maintain exclusively the ruble circulation, including the taxation system.

A guaranteed fund would be established to provide the FEBED's operations on ruble convertibility with guarantees for foreign investment and loans. Its activity will be determined by the operations on convertible currency and the volume of assets

guaranteed by foreign partners. Establishment of this fund will require natural resources of the region, including ore reserves of non-ferrous and precious metals, forestry and fishery resources, and furs, to be transferred exclusively into the possession of the local government in accordance with the agreement between the Association of the Far Eastern Territories as a region's representative on the one hand, and the governments of the USSR and the RSFSR, on the other. Security for currency transactions by the FEBED and partial payment balance will require the accumulation of a gold reserve in the FEBED at the expense of the region's gold mining industry. In addition, the sources for the guaranteed fund could be as follows:

- The revenues in hard currency drawn from the sales of enterprises into the ownership of foreign juridical and physical persons.
- Partial revenues in hard currency from foreign trade and business activities accumulated by the local governments.
- Partial revenues from rental payments, payments for granting concessions, infrastructure services, etc.
- Partial tax revenues in hard currency, revenues from securities, and deposits in foreign banks.
- Foreign credits to form a guaranteed fund and to provide convertible means of payment in the region.
- Guaranteed funds in hard currency specially allotted by the National Monetary Fund.
- The property of the Soviet enterprises and local governments, including plots of land.
- Plots of land for prospective economic activity that under certain conditions can be transferred into the possession of foreign partners as compensation for losses.

These suggestions were prepared in May 1991, and discussed together with Russian Government members headed by Mr. Silaev (Prime Minister) at Khabarovsk. These incentives received support, however, this was before the Presidential Election in Russia.

Unfortunately, everything finished at the same moment when it began. After the "coup" in August 1991, the "Russian Party" became the "new ruling party." The task to encourage regions and republics in their struggle with the USSR Government and to accelerate the decentralization of economic life reverted toward strengthening centralization, to secure the state and to gather as much economic resources as possible into the governmental hands.

The new Russian Government began to prepare for radical economic reform. The general ideology of this reform excluded the idea of incentives for regions. The reform began in January 1992 as the common basis for all regional modernization of governmental economic policy. The situation changed once more.

REALITY

Economic reform carried out by the Government includes two main blocks: macroeconomic regulators of economic activities and stimulation on the microlevel, in particular on the regional level. Almost all the measures taken by the Government are directed at macroregulation, as the second block of reforms is particularly absent. The absence of clearly marked regional policy in some regions and particularly in the Russian Far East, causes a hard economic situation which aggravates the general situation in Russian economics.

The economic crisis in the Far East started in 1991, although some production decline occurred as early as 1988, with a lowering of macroeconomic indices that were speedier in the Far East than in Russia as a whole. In 1991 the general drop in industrial production in Russia was about 5 percent, but in the Far East, it was about 7 percent.

In practically all industries except electric power and canned fish manufacturing, the output drop manifested itself naturally, with the best year for production of most items being 1988. Coal output decreased during 3 years by 20 percent, steel smelting—almost by 25 percent, timber harvesting—by 32 percent during 4 years, cement production—by 10 percent, and fish harvesting—by 11 percent.

Production decrease was not similar in all the industries. As a result the industrial production structure changed considerably. The share of engineering industry and forest harvesting decreased significantly, but the share of non-ferrous metal output went up. The engineering industry was influenced by consecutive reduction of military orders after 1989. Military engineering made up over one-third of the total of the region's engineering industry. A reduction in military orders affected almost all the enterprises and averaged about 40 percent. Until the beginning of 1992 there was still hope that at least some enterprises that manufactured expensive and high quality machinery would continue to receive military orders, but at this time it is evident that will not happen. Military budget reduction resulted in a military machinery production slump at all the military enterprises without exclusion.

The production slump went on all through 1991 against the background of fast price growth. In addition to a single price rise in April, inflation started to wind up after receiving a spur in May—June. Price increases occurred not at the consumer level but mainly at the wholesale market level. The industrial product deflator in the whole country for the year was over 205 percent: in the Far East it was over 220 percent. In 1991 as a whole wholesale prices increased 2.3 times and retail prices 2.1 times. Monetary income of the population increased approximately on the same scale. The production slump affected the balance between population income and goods availability at the market which was already unfavorable. The gap between demand and supply when considering delayed demand, was over 50 percent in favor of demand. This situation explains price increase tactics pursued by manufacturers from the beginning of this year: ready sale was achieved even with very high prices at the expense of high money accumulation.

The situation took a turn for the worse from the beginning of 1992. The Government began establishing the course for a budget entailing no deficit and used two very painful instruments. First of all, prices were sharply increased. The price-

raising program was declared as price-liberalization. However, price-liberalization is possible only in the case of real competition between producers. In Russia it is ruled out because the existing industrial structure was monopolistic for dozens of years and alternative structures do not yet exist. What really happened was general and catastrophic in the extent of price increases.

At the same time budget grants for nonprofitable industries (excluding a highly limited number of them) were canceled. This also resulted in sharp price growth because losses compensated by grants were immediately included in prices. Especially painfully affected were the food products which had been almost entirely covered by budget grants. In the Far East price liberalization again caused more serious consequences than it did in the country as a whole.

Intensified price growth in the region is related in many respects to increased expenses for product manufacturing and transportation costs. Currently this price growth is not compensated for by centralized budget redistribution. Products become uncompetitive because consumers will select cheaper ones and will not simply "convert funds" provided by the Center "into commodities." Besides that, financial resources of Far East enterprises are significantly lower than in other regions of the country.

The Government has taken a number of anti-inflation measures which were supposed to prevent hyper-inflation development. The discount rate for State bank loans was augmented to 20 percent, which automatically led to a commercial bank discount rate increase at a minimum of 23 percent. For an artificial lowering of enterprise payment funds, index-linking of working capital was prohibited, and working capital increase limits were determined on a scale of 50 percent of the price increase rate set by the Government. Because enterprises were not allowed to use loans but were required to increase their working capital at their own expense, an augmented rate of reserve capital was introduced in February 1992, which by April 1992 already constituted 20 percent of commercial banks' outside funds. However, enterprises proceeded to decrease their output without reducing staff and because of this, both prices and salaries rose.

A typical example is Khabarovsk Territory where, in the January—April 1992 period, the prices of consumer goods increased 7.7 times as the general price index increased 4 times. At the same time salaries grew 5.6 times, and the number of unemployed people hardly increased. According to information for the first half of 1992, the unemployed in the territory make up a little more than 3,000. Output volumes in comparison with corresponding months of the last year went down: in January by 16.5 percent, in February by 14 percent, in March by 12 percent, in January—July by 13 percent.

All this caused rapid growth of production costs and consequently rapid price growth. The limited growth of working capital complicated the settling of accounts between enterprises and resulted in one of the most serious problems which shook the economy during the first half of the year and which has not yet been completely solved—the problem of nonpayments.

This problem was caused to a great extent by the Government and actions by the Central Russia bank. In January the Central bank prohibited the transfer of payment

orders by telegraph, and instead required all accounts to be settled by mail, which took 2—3 months instead of 3—4 days. The goal was to make enterprises reduce their demand for acquired production and to buy only indispensable items which would stimulate economic structural reconstruction and prevent low quality goods output. However, real structural reconstruction required changes in technologies, time, and money. The enterprises chose another way: they preserved the previous demand scale and stopped paying for production that provided for their activities. This fact, combined with long terms of account settling, caused the general nonpayment.

In July 1991 debts of all the Far East enterprises totaled 1.9 billion rubles. In late April 1992 in Khabarovsk Territory the sum of mutual nonpayments alone totaled 18 billion rubles; late in June it surpassed 42 billion rubles, and by late July it reached 49 billion rubles. In comparison, the total industrial production in Khabarovsk Territory is about 50 billion rubles.

In June a number of decrees were issued for improving the financial status of enterprises. Special loans for working capital increase are supposed to be granted; the decision on loan size will be made either by the Ministry of Finance (if demand for a loan is over 500 million rubles) or by special local commissions headed by local administrations. The next step will be to declare bankrupt those enterprises whose position cannot be improved.

In addition to financial improvement, these measures shall provide great incentive to the privatization process. By this time privatization has many complications. In the Far East as a whole, non-state enterprises make up about 12 percent of the total number of enterprises. In Khabarovsk Territory they make up about 15 percent, but they provide only 9 percent of the total production. The time for privatization was lost; currently the amount of available funds is rather limited.

Carried out by the Government, the reforms have impacted the infrastructure most unfavorably. Today electric energy and heating fees in the Far East are the highest in all of Russia, and enterprises appear to be unable to pay for electric energy. The heating-energy supplying complex has no funds available for construction, equipment maintenance, or even for fuel purchase. Construction is carried out for credit only, and the rate for credit has reached 80 percent. The same situation applies for transport.

In addition to mutual nonpayments, an imbalance of the credit currency system is also accompanied by the lack of cash. This problem to a great extent was caused by the unreasonable policy of the Government and the Russia Central bank which couldn't anticipate the scope of the expected inflation and therefore did not provide a timely issue of the necessary amount of cash. The scale of the shortage of available cash is enormous, but still it is a factor restraining the demand of the population for solvency and price growth. For instance, in Khabarovsk Territory money emission in 1991 totaled 800 million rubles, yet in June 1992 it reached 1.8 billion rubles. However, this sum is obviously not adequate to pay salary debts for April and May; another 1.5 billion rubles of cash are necessary.

Cash shortage and accompanying negative consequences, including the growth of social tension in the society, are the result of improper application of monetary regulation methods for the economic cycle. The Government did not consider it its

duty to apply the classic regulation method—"stop-go"—instead it used only "stop." If the Government meant to stimulate production growth, it should have admitted that inflation growth was inevitable and by 1991 should have enhanced the emission of cash. However, the Government in trying to show the International Monetary Fund that inflation had no place in the country, provided ground for a new price spiral by the cash availability crisis.

In September—October prices can greatly increase when the salary debt is liquidated. As far as the Government reduced salary and price regulation, inflation can acquire an uncontrolled nature. Already today all the capital investments are frozen with a compensation term of more than three months, and available funds are invested practically only in trading operations. In summer, the price growth again increased as producers included their inflationary expectation into their expenses. External economic relations, which were always helpful in the Far East, currently do not play a very marked role in the economy of the Territory. The running of joint enterprises is in progress, but its influence on the regional economic development is insignificant. Early this year about 100 joint ventures were registered in the Far East. At the moment, although they total more than 100 in Khabarovsk Territory alone, they are mostly small in size. Their main sphere of investments though unproductive is traditional for the Far East—timber and fish.

A sphere of international cooperation—the investing of capital (which is of high priority for the Far East)—appears complex. Potential investors have no idea about the general economic situation in the region or where they can invest their money, except that Russia itself has no clear idea for what purpose and on what conditions these moneys can be received. There is no clear and intelligible control of foreign investments in the country as a whole; the Government canceled privileges that were granted to the Far East in the external economic sphere. But the strongest barrier to foreign investments is the inability of potential recipients both in the state structures and other structures to provide clear and effective suggestions for possible investments.

On July 1, a new order of external economic activities regulations will be introduced. Import duty will be introduced on a scale of 5 percent of imported goods' value, and this will cause imported articles to become more expensive. The special commercial rate of the ruble is canceled and instead the rate will be floating and will be fixed every week. These last measures will make the Ministry of Finance sharply increase expenses for currency purchasing to cover the external debt. Most possible is that the Ministry of Finance will start to press on the Russia Central bank the last enhanced readily convertible hard currency intervention to reduce the U.S. dollar's rate relative to the ruble. That will be one more mistake which will not only lead to an export drop, it will not increase imports, and consequently will aggravate the situation with a payments balance. Thus, in addition to the inflation splash in October—November, an actual sharp ruble devaluation is likely. All this means that the stabilizing of the economic situation projected for Fall 1992 will probably be delayed until 1993.

What measures are seen as primary for stabilizing the economic situation in the Far East and consequent stimulation of economic activities?

- The forced breaking of big enterprises is necessary where it is justified by technology; on their foundation small joint stock or private units shall be established.
- Credits shall be opened automatically for such enterprises for production stimulation, reconstruction, and technological improvement.
- Freezing of the above normative salary increase allowing the salary growth; the author believes that average salary growth rate and price ratio should not be over 0.7.
- Sharp reduction of taxes for products. The tax should practically equal to zero in case of physical growth of production and trading; it should be prohibitive in the case of output volume decrease.
- Declaration of a 12-month moratorium for law revision in the sphere of private business undertaking and market and finance management.
- Ceasing of artificial support of a high ruble course and conditions providing for direct goods intervention for foreign trading companies and eventually for hard currency intervention.
- Adoption of laws on foreign property in Russian territory; Central bank of Russia guarantees for land buying and selling, and guarantees for obligations.
- Authorization of joint and foreign banks in the territory of Russia, established with complete cycle of financial operations.

HOPES

The failure of hopes for quick results from reform in Russia as a whole was the reason for the beginning of talks about a new regional policy. The second reason for the reviving of the Far Easterner's hopes was the planned visit of Mr. Yeltsin to Japan in September 1992. According to the former Soviet approach to policy, it is necessary to address concerns regarding the Far East before the declaration about paying great attention to the Pacific Rim as a whole and to the Russian Far East in particular.

That is why a project of the new Presidential Decree has been prepared to correspond with the aforementioned model of the Far Eastern economic development. The main point of this decree is the preparation of the new Program for the Economic and Social Development of the Russian Far East.

But new declarations in the form of new programs and high level decrees do not provide a sufficient base for increasing the scale of the Pacific economic ties in the Russian Far East. The main obstacles remain the same: general instability of the economy, collapse of the financial system (the most discouraging example has been the USSR Foreign Economic Exchange Bank bankruptcy), and the lack of differences in the regulation of international economic relations between regions.

The general regulation is geared to the reform of the former centralized method of dealing with foreign partners. The Presidential Decree regarding foreign trade liberalization appeared as recently as December 1991. The trade between Far East and Pacific countries began to increase, especially with China. The number of joint

ventures in the Russian Far East increased from 130 in December 1991 to 600 in June 1992. The domestic market in the Far East has not been overfilled by Chinese consumer goods. The reconstruction of the traditional economic ties is going on now with some commodities and food that this region traditionally received from the internal part of Russia and the USSR as a whole now being supplied by China and other Pacific countries.

But the central Government has done its best to stop this process of further decentralization of foreign trade. In January 1992 new custom taxes and a new order of licensing and quotation were introduced. These led to the serious centralization of foreign trade. In July 1992 import taxes were introduced, commodity licenses and quotas were canceled, and in their place a new type of license appeared—a license to export so-called strategic commodities. Practically all commodities which can be exported in principle must be exported only after receiving such license. And the Ministry of Foreign Economic Relations in Moscow is the only place where exporters can receive this license.

The Russian Far East is a very special region. Because of high transport expenses and relatively high wages it cannot be entirely dependent upon the domestic market and because of the magnitude of traditional ties with continental regions of Russia, it cannot be entirely dependent upon the international market of the Pacific Rim. It is therefore necessary to construct some mixed variant of the foreign economic relations regulation.