

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

**SELECTED MACROECONOMIC
ISSUES OF COMMON CONCERN
TO THE CENTRAL ASIAN
COUNTRIES AND THE
RUSSIAN FEDERATION**



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PREFACE

Over a period of four years, beginning in 1993, the ESCAP secretariat organized a series of national workshops on macroeconomic reforms in each of the Central Asian countries. The workshops addressed the following issues: the management of monetary, fiscal and exchange rate policies, the liberalization of trade, the privatization of State enterprises and foreign direct investment. The objective was to sensitize policy makers to these areas of economic governance and to familiarize them with the experience of other developing countries of the Asian and Pacific region in addressing the related issues. Policy makers were thus afforded an opportunity to make an informed choice from among a range of options, taking into account the unique features of their own countries. During these workshops it was suggested that a number of macroeconomic issues commonly faced by the Central Asian countries merited attention. Among them were high inter-enterprise indebtedness and payment arrears, the management of banking reforms, and revitalization of economic relationships between the Central Asian countries and the Russian Federation. These issues were discussed at a subregional seminar held in Almaty in September 1996.

The present publication contains two papers from that seminar. The first paper deals with the problem of inter-enterprise arrears. In the countries of the former Soviet Union the cause of this problem goes far beyond the problems related to the transformation from central planning to a market-oriented economy. Macroeconomic instability, underdevelopment of financial systems, structural inadequacies, and a breakdown of previous trade and payment systems have contributed to the severity of this problem in its domestic as well as interstate dimensions.

The second paper examines the issue of economic cooperation and the renewal of intercountry economic linkages between the Central Asian countries and the Russian Federation. The revitalization of this economic relationship is important for speedy restoration of growth in these economies.

The two papers contain insights which should provide a useful basis for macroeconomic policy formulation. It should be stressed that successful resolution of the problem of inter-enterprise arrears and revitalization of economic cooperation between the countries of Central Asia and the Russian Federation is crucial for achieving macroeconomic stabilization and sustained growth.

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**INTER-ENTERPRISE
ARREARS IN THE CENTRAL
ASIAN COUNTRIES AND THE
RUSSIAN FEDERATION***

* Prepared by Nikolaj Ordnung, consultant to ESCAP.

INTRODUCTION

In the process of transition from central planning to a market-oriented system, many countries have experienced the problem of enterprises not receiving payments from each other on time for goods and services delivered. Such nonpayment – or inter-enterprise arrears – is a manifestation of lack of financial discipline and brings about negative effects at both the macroeconomic and microeconomic levels. The potential adverse effects of inter-enterprise arrears are usually much wider than their direct impact on enterprises that did not get paid for goods and services delivered. These enterprises, which become involuntary, forced creditors may suffer from lack of liquidity and become, in turn, indebted to their suppliers and incur arrears on their payables. A sort of chain reaction develops in which enterprises get quickly entangled in multiple layers of arrears, with one enterprise's payment to a second contingent on receipt of payment from a third, and so on.

As a result, the viability of not only loss making enterprises but also of fundamentally profitable firms can be threatened because of the latter's lack of liquidity evoked by the "domino" effect. At the same time, massive amounts of receivables and payables on enterprise balance sheets, often of dubious value, can confuse and hinder a realistic assessment of the financial situation of enterprises by their own managers, suppliers, banks and potential investors. Thus a sound basis for investment, credit, and privatization decisions is eroded.

At a macroeconomic level the excessive growth of inter-enterprise arrears, and more generally, of trade credits, can impair the effectiveness of monetary policy by providing an inducement for expansion of bank credit which, of course, may give additional impetus to inflation. At critical levels, the inter-enterprise arrears problem – sometimes called the "nonpayment crisis" – may threaten to bring about a complete disruption in the payments system and cause a drastic decline in real output of the economy.

However, when pointing out the potential adverse effects of the expansion of trade credit and especially of the related growth of inter-enterprise arrears it should be mentioned that this phenomenon was bound to appear with the transition to market economy. The explanation lies in the fact that under central planning, access to bank credit was

practically automatic for activities approved by the plan, and the need for inter-enterprise credit was extremely limited. Inter-enterprise transactions were carried out by making money transfers through the old interbank settlement system. A supplier usually received payment by submitting a payment demand order to its own bank requesting payment from the buyer. Under this system, overdue payments were only a minor problem and any arrears existing at the end of the financial year were written off by the extension of automatic credit.

With the move away from central planning all this has changed. The banking sector ceased to function as an administrative arm of the planning mechanism, and bank credit to enterprises ceased to be automatic. On the other hand, the enterprises lost the "safe haven" of state orders and had to look for customers, start to engage in marketing activities, and eventually also attract buyers by providing trade (suppliers) credits. In established market economies trade credits play an important role in facilitating business transactions and it is quite normal that their total magnitude is larger than that of bank credits and amounts to 20 per cent or more of the annual GDP. From this perspective, the expansion of inter-enterprise credit (but unfortunately also of the arrears) in the Russian Federation and the Central Asian countries is to a certain extent natural and represents an integral component of transition to a functioning market economy.

However, the explosive growth of inter-enterprise credit and arrears after the break-up of the former Soviet Union has been a complex process, encompassing also a number of negative elements linked to the specific features of the transition period and to certain weaknesses of the policy measures adopted to deal with this problem.

I. EVOLUTION OF INTER-ENTERPRISE ARREARS IN THE RUSSIAN FEDERATION AND CENTRAL ASIAN COUNTRIES

A. GENERAL TRENDS

The problem of inter-enterprise arrears emerged in early 1992 in the course of combination of two processes of historical importance: the dissolution of the former Soviet Union (FSU) and the move towards market-oriented economy which was marked at the initial stage in particular by liberalization of prices and loosening of central controls over the activities of state owned enterprises (SOEs). Inflation which immediately engulfed the economies of the FSU countries after January 1992 price liberalization, drastically depreciated the existing stock of working capital of the SOEs and at the same time provided a strong impetus for SOEs to borrow. However, the access to bank credit became quite limited (especially in those FSU countries where governments tried to bring inflation under control) and thus to avoid the disruption and/or curtailment of their activities, the management of SOEs turned to inter-enterprise credit as the main solution to the financial squeeze. An additional factor pushing the SOEs in this direction was the bottlenecks in payments system, especially the collapse of the inter-republican financial settlement system consequent to the break-up of the former Soviet Union.

The distinct feature of the behaviour of SOEs in early 1992 was thus reliance on accumulating arrears in regard to their suppliers and, at the same time, a high degree of readiness to supply goods and services to their customers without insisting on sufficient guarantees to obtain timely payments. Of course, such a behavior was based on an implicit expectation that the past paternalistic attitude of the governments will continue and at some point of time the stabilization policy will be abandoned, massive credit injection into the economy will take place and all indebted SOEs will be bailed out.

The quantitative dimensions of the rise in inter-enterprise arrears in early 1992 can be illustrated in the case of the Russian Federation for which the data is available in required detail. From the data in table I.1, it can be seen that inter-enterprise arrears in nominal terms increased from the level of Rouble (Rb) 39 billion on January 1, 1992, to Rb 3 trillion on June 30,

1992, i.e. approximately 77 times. The nominal bank credit increased only about 3 times from Rb 450 to 1,400 billion. Even more telling are the magnitudes expressed in real terms which clearly reflect the bank credit squeeze to less than one third of its initial level from Rb 450 to 140 billion and the explosion of inter-enterprise arrears by factor exceeding 7, from Rb 39 to 299 billion in real terms between January 1, and June 30, 1992. As a result, the relative importance of these two forms of "financing" changed completely: inter-enterprise arrears which at the beginning of 1992 represented a negligible amount, equal to less than 8 per cent of bank credit represented around 200 per cent of the total bank credit by June 1992.

Table I.1. Credit and inter-enterprise arrears in the Russian Federation, 1992

(Billions of roubles)

End Month	Nominal bank credit	Real bank credit	Nominal arrears	Real arrears	Arrears/bank credit
December 1991	450	450	39	39	0.078
January 1992	510	148	141	41	0.277
February 1992	700	147	390	82	0.558
March 1992	920	149	800	129	0.870
April 1992	1 050	139	1 800	239	1.710
May 1992	1 050	125	2 050	243	1.952
June 1992	1 400	140	3 000	299	2.143
July 1992	2 300	207	1 190	107	0.517

Source: Russian Centre for Economic Reform. Quoted from: Jacek Rostowski, "Interenterprise Arrears in Post-Communist Economies", IMF Working Paper WP/94/43 (IMF, Washington D.C., April 1994), p. 7.

The rapid growth of inter-enterprise arrears in the first half of 1992 was reflected also in their exploding ratios to other macroeconomic aggregates. By mid-1992 inter-enterprise arrears in the Russian Federation had risen from less than 4 to 21 per cent of GDP (Cirtin and Lahiri 1995)¹ and even more dramatic was their increase from less than 3 per cent to more than 150 per cent of broad money. This phenomenon spread also to the other states belonging to the Commonwealth of Independent States (CIS) including the Central Asian republics (CARs) and became an issue of major concern among the policy-makers.

¹ Other sources give even higher estimates of approximately 23-45 per cent of GDP.

To deal with the crisis situation, CIS representatives' meetings took place in Bishkek and Tashkent in May 1992. In these meetings a broad agreement was reached on a four-pronged plan of action to (1) increase the responsibility of enterprises for assuring prompt payment for their sales; (2) raise the interest rate that enterprises were to charge on arrears; (3) net out arrears first within each state and subsequently at the interstate level; and (4) replenish the working capital of state enterprises. While action on the first two components of policy package was not immediately obvious, all countries of the CIS carried out netting out exercises for inter-enterprise arrears and followed these up with additional bank credit to clear the net outstanding claims as well as to replenish the working capital of enterprises. Although these actions reduced the volume of arrears substantially, the solution of the arrears problem proved to be temporary and in the following period the inter-enterprise arrears started accumulating again. At the same time, the injections of additional credit to bail out enterprises – the net debtors, intensified inflationary pressures.

The Russian Federation provides a good example of these developments. In response to the many-fold increase in inter-enterprise arrears by June 1992, the authorities carried out a multilateral netting out of arrears in the second half of 1992, through the establishment and operation of special accounts in commercial banks. The exercise reduced the stock of arrears from about Rb 3 trillion in July to Rb 450-480 billion in October 1992 (Bigman and Leite 1993) which represented about 3.5 per cent of GDP. Enterprises – the net creditors were subsequently enabled to use their net balances for paying taxes and for payment of liabilities to banks. These balances were thus monetized. The netting out exercise was accompanied by a massive injection of bank credit into the economy which rose by more than 100 per cent in the third quarter of 1992 and by another 65 per cent in the fourth quarter (Bigman and Leite 1993). This mostly reflected the expansion of lending by the Central Bank of the Russian Federation (CBR) to commercial banks at highly subsidized rates with loans being directed to SOEs and sectors that were structurally net debtors. The main result of this credit expansion was weakening of financial discipline and reinforcing of inflation pressures.

In the subsequent period from 1993 to late 1994, the developments in the Russian Federation and Central Asian countries proved that netting out exercises of 1992 and early 1993 did not provide a permanent cure to inter-enterprise arrears problem. It reappeared now and again with different degrees of intensity. One of the few analytical works devoted to this topic and covering not only the Russian Federation but also some of the Central Asian countries (Citrin and Lahiri 1995) described the situation along the following lines, based on the data contained in table I.2.

**Table I.2. Russian Federation and selected Central Asian countries:
inter-enterprise arrears, 1992-1994¹**

(End of period)

	1992	1993				1994		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
(As percentage of GDP)²								
Azerbaijan	...	1.8	9.1	12.6	15.0	13.5	14.6	...
Kazakhstan	1.7	1.9	1.9	3.4	5.0	4.0	3.7	7.1
Kyrgyzstan	...	9.1	8.7	9.0	7.9	...	...	...
Russian Federation	...	...	...	...	3.0	4.0	2.6	...
Industry and construction	...	2.6	2.3	2.2	2.7	3.6	2.3	...
Turkmenistan	...	...	...	...	...	2.9	...	...
(As percentage of broad money)³								
Azerbaijan	34.2	5.8	19.7	44.9	42.8	57.8	56.7	...
Kazakhstan	9.2	12.8	12.8	28.4	81.1	35.3	...	214.2
Kyrgyzstan	107.8	105.0	129.1	160.5	250.7	248.1	256.4	227.8
Russian Federation	...	...	...	26.5	33.1	49.5	48.0	54.7
Industry and construction	19.3	19.9	17.1	24.1	29.6	44.6	42.9	45.5
Turkmenistan	...	...	...	...	63.1	66.2	81.4	100.8

Source: International Monetary Fund, *Policy Experiences and Issues in the Baltics, Russia, and Other Countries of the Former Soviet Union*, edited by D.A. Citrin and A.K. Lahiri, IMF Occasional Paper 133 (IMF, Washington D.C., December 1995), p. 18.

¹ Defined as overdue payables for every country except Turkmenistan, for which data refer to overdue receivables.

² Defined as average during the quarter as a percentage of annualized quarterly GDP.

³ Defined as the ratio of the end-of-period stock of broad money.

First, it was pointed out that while in Kyrgyzstan the arrears problem diminished, in Azerbaijan and Kazakhstan it escalated rapidly. The Russian Federation and Turkmenistan were identified as countries in "intermediate position" where the arrears problem slowly increased.

However, in case of Kyrgyzstan while the stock of inter-enterprise arrears in 1993 indeed showed a declining trend in terms of their proportion of GDP from 9.1 to 7.9 per cent, the ratio to broad money shot up from 105 per cent to about 250 per cent and remained at that extremely high level until the third quarter of 1994.

In Kazakhstan, arrears rose sharply in the second half of 1993 from 1.9 to 5 per cent of GDP. In response, in early 1994, the Government of Kazakhstan carried out a netting operation, following which net creditors were paid the full amount of their claims. Part of these payments was in the form of government bonds, where the debtors became liable to the government and their payment obligations were to be enforced through the threat of bankruptcy. In the event, most of the debt to the government was not repaid, and liquidation proceedings have only been initiated for a small proportion of the debtors. The arrears declined to 3.7 per cent of GDP by June 1994; but, again almost doubled to 7.1 per cent of GDP within the third quarter of 1994. In Azerbaijan, arrears escalated even at a higher pace rising from 1.8 to 15 per cent of GDP in the course of 1993 in spite of a clearing operation carried out in the third quarter of 1993. However, a slight decline and certain stabilization could be observed in the subsequent period when arrears were kept under 15 per cent of GDP in the first half of 1994.

In regard to Uzbekistan, little information is readily available regarding the volume of inter-enterprise arrears. However, it is likely that Uzbekistan belongs to the group of countries with mounting arrears problem. The indication of this is seen in the fact that the authorities in that country undertook, under the auspices of the central bank, a netting out of gross overdue inter-enterprise claims and liabilities between August 15 and September 5, 1994.

As mentioned above, the Russian Federation and Turkmenistan were assessed as countries with modest rise in inter-enterprise arrears (as measured against GDP) during the period 1993 – late 1994. But the arrears did increase more significantly in relation to broad money in both countries which had, of course, adverse implications for the effective conduct of monetary policy. Also, the interstate component of inter-enterprise arrears was a problematic aspect of the arrears problem in both the Russian Federation and Turkmenistan, reflecting in particular debts on energy deliveries. In Turkmenistan overdue receivables of gas companies from enterprises in other states of the CIS rose by about

US\$ 0.5 billion during the first nine months of 1994 to about 60 per cent of GDP at the end of September 1994. These nonpayments significantly complicated inflation control in Turkmenistan, with the authorities granting additional credits to enterprises in lieu of the receipts from abroad.²

In the subsequent period it seems that the problem of inter-enterprise arrears has somewhat lessened, though experiencing temporary upswings. Coming back to the case of the Russian Federation, after having fluctuated under 3 per cent of GDP in 1993, in 1994, especially around October-November the arrears shot up to another peak reaching about 5 per cent of GDP to decline afterwards again to about 3-4 per cent of GDP in the early part of 1995.

In this connection it is not surprising that some of the Russian analysts came to the following conclusion: "It is obvious, that in quantitative terms the problem of mutual inter-enterprise arrears (nonpayment) has lost its sharpness. Compared to international standards the magnitude of arrears seems to be quite acceptable. In general the enterprises are at present largely adapting themselves to market environment. In other words, *the payment crises at the macroeconomic level in the Russian Federation does not exist, which does not mean the complete absence of the problem of nonpayments as such.*" (Afanasjev, Kuznetsov and Isaeva 1995a: 58)

Due to the paucity of data on the more recent development of inter-enterprise arrears in Central Asian republics it is not feasible and appropriate to draw conclusions. However, from the fragmentary information available it seems that inter-enterprise arrears continued to plague the CARs in spite of the efforts of the governments to deal with this problem.

The Asian Development Bank (ADB) reported that "the Government (of Kazakhstan) periodically attempted to deal with the situation of growing inter-enterprise arrears through clearing operations. In early 1994, in the latest action, quasifiscal operation resulted in the Government assuming debts or other obligations equivalent to more than 7 per cent of GDP. The operation provided a clear balance sheet for firms and financial institutions, but exacerbated existing fiscal and monetary difficulties. The 1994 clearing exercise was financed ultimately through credit creation, as

² The nonpayments for gas deliveries (Ukraine being the largest debtor) had, of course, much broader adverse effects on the economy of Turkmenistan. It was the main cause of turning the government budget from surplus into a sizeable deficit (tax on gas exports was supposed to be the main source of revenues) and also of the massive devaluation of the national currency – Manat – during 1994.

were similar exercises in the past. These exercises have monetized the credit creation by the enterprises, increasing the inflationary pressure". (Asian Development Bank 1995a: 10).

However, the ADB points out that a distinct change in policy occurred later in 1994, when the National Bank of Kazakhstan (NBK) tightened credit policies with the objective to reduce inflation and to improve financial discipline. In July 1994, banks were instructed not to execute payment orders for clients without adequate funds. One can expect that with the credit squeeze the enterprises would be tempted to resort again to inter-enterprise credit (or more precisely to accumulating arrears). It was reported that the tight fiscal and monetary policy which succeeded in reducing budget deficit and bringing inflation under control was at some point accompanied by the rise in inter-enterprise arrears which had reached, at the end of June 1995, to the level of Tenge 123 billion or about 35 per cent of GDP (Economist Intelligence Unit 1995: 17). This figure seems to be rather on the high side and deserves clarification.

In regard to Kyrgyzstan the ADB reported that "at the end of 1994, inter-enterprise arrears represented, in the World Bank's estimation, approximately 14 per cent of GDP. Originating in the breakdown of the payments mechanisms after the dissolution of the (former) Soviet Union, inter-enterprise credits were freely extended by suppliers and banks, often at the direction of Government ministries eager to assist troubled firms or farms. The existence of these debts inhibits even potentially viable establishments from obtaining new credit. There appears little alternative but to design a meaningful debt reduction exercise, one that significantly reduces the internal debt overhang in the economy, without increasing the already considerable moral hazard of encouraging improvident borrowing." (Asian Development Bank 1995b: 11) We have quoted the ADB at length just to give the indication of the similarity of the situation found in the various CARs. However, at this point, it would be more interesting to identify the general trends in the magnitude and severity of the inter-enterprise arrears problem and from the above quoted figure of 14 per cent of GDP in June 1994, it appears that compared to 1993 (8.9 per cent GDP, see table I.2) the arrears problem intensified in Kyrgyzstan. Nevertheless one has to add a word of caution: sometimes the inter-enterprise arrears are not strictly defined and the figures on arrears may also include overdue loans owed to the commercial banks.

From what has been said so far it is quite obvious that it is not appropriate to make far reaching generalizations about the trends in the magnitude and severity of the inter-enterprise arrears problem. In the Russian Federation, apparently the problem is not as serious as it used to be especially in 1992 (and to certain extent also in October-November 1994); but in some of the Central Asian countries its severity may be still high.

B. CHANGING PATTERN OF ARREARS

Turning to the pattern, or structural characteristics of the inter-enterprise arrears, at least in regard to the Russian Federation, a distinct trend may be discerned, i.e. from a rather general nature of inter-enterprise arrears engulfing all sectors of the economy towards a situation in which arrears are more concentrated in certain sectors.

The main trend consists in increasing share of the electrical energy and fuel industries in the total amount of overdue payables (Organization for Economic Cooperation and Development 1995: 104).³ The share of these two subsectors in total arrears (overdue payables) almost doubled from 24.2 per cent at the end of 1992 to 46.5 per cent at the end of the third quarter of 1994. According to other sources (Afanasjev, Kuznetsov and Isaeva 1995: 58) the share of these two subsectors, together with machinery manufacturing, amounted to 69 per cent of total industrial arrears in early 1995. Electric energy and fuel industries are also the biggest creditors (usually involuntary) to the other sectors. Their combined share in the total overdue indebtedness (arrears) of buyers of industrial products increased from 40.1 per cent in January 1994 to 54.9 per cent in May 1995.

The reasons for this phenomenon may be connected with the fact that energy sector is dominated by large enterprises that are commonly perceived to be "too big to fail" and it is likely that the expectations of an eventual bailout by the government encouraged these companies to continue to supply energy disregarding the accumulating arrears and diminishing prospects of getting paid by their customers. Given the strong links between the government and the energy industry, and the tax exemptions that the latter frequently enjoys (including the toleration of nonpayment of taxes and accumulation of tax arrears), this might be interpreted as indirect budget - financed assistance to energy - consuming industry.

When examining the changing pattern of inter-enterprise arrears one should place them into a broader context with other types of nonpayment or arrears that are typical for the Russian Federation and other CIS transition economies. Besides the inter-enterprise arrears we find also the enterprises running up arrears on their tax and other

³ The OECD experts, while acknowledging that the arrears explosion in 1994 like that of 1992 resulted from the tightening of credit, also see the important difference in 1994 arrears being concentrated in the energy sector, or in payments for energy, while inter-enterprise arrears crises was a much more general problem in 1992.

payments to the state budget, on repayments of bank loans, and, on the payment of wages to their employees. These various types of arrears are interrelated in a complex way through both the reactions and mutual substitution. Thus, for example, an increase in arrears to suppliers may compensate for the decline in overdue indebtedness of enterprises to banks; tax arrears may be a substitute for wage arrears, etc. To give the indication of relative importance of the various types, let us mention that in 1994 nonpayment crises in the Russian Federation, enterprises owed as of 1 November some Rb 52 trillion to suppliers, Rb 16 trillion in back taxes, and roughly Rb 5 trillion in overdue payments to banks. In addition enterprises owed approximately Rb 4.7 trillion in back wages (Organization for Economic Cooperation and Development 1995: 104).

It seems that in 1994-1995 period, one of the important structural shifts consisted in the increasing share of tax arrears. While at the beginning of 1994 the tax arrears amounted to about 18 per cent of the volume of inter-enterprise arrears, in September 1995 this ratio increased to almost 41 per cent. This can be interpreted as a relative improvement of payments discipline in transactions among the enterprises and deterioration of firms' behavior vis-à-vis the state budget.

"While 1994 was the last year of the relative growth of inter-enterprise arrears, so now we live in a period of nonpayments into the Federal Budget." (Afanasjev 1996: 1) In general, the priorities of the enterprises' management in dealing with their commitments were, in early 1996, characterized by giving first priority to the repayment of bank loans, second to pay their suppliers, third to pay the wage earners, and the last came the government.

The shortfall in payments of taxes and other contributions into the extra-budgetary funds (e.g. pension fund) reached critical proportions in the first half of 1996. It was reported that the actually collected revenues of the Russian Federation budget reached less than two thirds of the planned (budgeted) level for January-June 1996 period.⁴ The alarming level of tax arrears was reportedly the reason for the IMF to discontinue in July 1996 the disbursement of the credit previously granted to the Russian Federation. At the time of writing this paper, the Government of the Russian Federation was involved in discussions with the IMF concerning the measures to improve tax collection procedures, and, at the same time to reduce the government expenditures, in particular investment outlays, to keep the budget deficit within targeted level.

⁴ According to Reuter Press Agency quoted in *Hospodarske noviny*, Prague, August 20, 1996, p. 1.

The government, however, is not only in the position of a creditor in the broader context of arrears problem: it may be also a big debtor. In the Russian Federation, it was estimated that in 1994 in the gross total of arrears in the economy the government's share amounted to about 30 per cent (Shmeliev 1995: 28). These arrears consist mainly of delays in payment of wages of employees of the SOEs and state institutions financed from the budget, as well as delays in payment of pensions, stipends and other social benefits. The whole issue of wage and social benefits arrears came to the forefront during the recent presidential elections campaign in the Russian Federation, but there are indications that also in some Central Asian republics, wage and pension arrears are becoming critical.⁵ Needless to say that delays in wage and pension payments which under inflationary environment mean an effective and sometimes quite drastic reduction in real incomes may seriously erode public support for market reform and stabilization policies. It should be noted that the failure of the government (at different levels) to pay wages and social benefits, and/or to pay for goods delivered under state orders, may be, to some extent, the consequence of the shortfall in government revenues – mainly accumulating tax arrears.

The nexus among the various types of arrears is a complex phenomenon. It may be of interest to refer to the recent analysis of the IMF (International Monetary Fund 1996: 88-89) which provided some general observations on this issue, including insights into the interrelationship between wage and tax arrears under certain type of government policy.

Besides identifying the tax arrears as a growing problem in many transition economies, including the so called "fast" reformers like Poland, Hungary, Czech and Slovak Republics, where the stocks of tax arrears were estimated at the level of 3-7 per cent of GDP in 1994, the report points out that the governments may often tolerate tax arrears because the short-term benefits of the liquidation of the distressed firms may be considered small in relation to much greater political costs. Indeed, tax arrears are a kind of subsidy to loss-making firms: in most cases, they can be thought of as wage subsidies, because wage taxes – notably social security contributions – are often the biggest single tax liability of

⁵ For example, in September 1994 the wage and pension arrears problem in Kyrgyzstan became pressing enough to require Presidential decrees on improving the supply of goods to the population by paying wages, benefits, pensions and social security payments on time (Kyrgyzkaban, Bishkek, 5 September 1994). It was also reported that in May 1995 wage arrears in Kazakhstan stood at 5.4 per cent of GDP and a number of strike threats appeared among state employees and industrial workers (EIU, Country Report, 4th quarter 1995), p. 17.

distressed enterprises. Such practices entail a moral hazard, however, as the failure to take action against these firms perpetuates the accumulation of arrears and encourages the expectation of a generalized settlement on concessional terms of all arrears.

Evidence of such moral hazard implications can be seen in the accumulation of wage arrears in many economies in transition, particularly those of the former Soviet Union. An enterprise may frequently pay a low cash wage but record a higher accrued wage in the firm's accounts; the difference between the two is wage arrears. One explanation for this practice is that wage arrears are a useful lobbying tool that can help the firm obtain additional subsidies from the government, which may be effective especially in case of large enterprises in sectors like mining etc.

In accumulating large wage arrears, enterprises may be responding to the incentives created by government policies. This was likely the case in the Russian Federation where, in early 1994, the government introduced a scheme that allowed liquidity - constrained firms to set aside 30 per cent of their income to pay wages and to defer tax payments to the extent that the remainder was inadequate to cover tax liabilities. In practice, such deferrals were for an indefinite period, and the taxes deferred neither accrued interest nor were subject to late penalties. Wage arrears did fall after the introduction of the rule, but at the cost of a large increase in tax arrears. Moreover, the scheme provided a means by which enterprises could implicitly borrow funds at a negative real interest rate by not paying their tax liabilities and accumulating tax arrears on terms more favourable than could have been obtained through direct borrowing. All enterprises therefore had an incentive to run up wage arrears - irrespective of their financial situation.⁶

⁶ This scheme was eliminated in early 1996. In January 1996 a Presidential Decree No. 65 was also issued aimed at the improvement of tax payments discipline of enterprises and organizations through a rather innovative method; for details see section III.

II. INITIAL CAUSES OF INTER-ENTERPRISE ARREARS AND FACTORS EXACERBATING THE PROBLEM

Causes and factors behind the explosive growth of inter-enterprise arrears have been already briefly touched upon in the introduction and the preceding section reviewing the general trends. Let us now have a closer look at some of these causes and factors which have been changing over time in spite of a relatively short period of transition to market-oriented economy in the Russian Federation and the Central Asian countries.

A. ADAPTATION TO NORMAL MARKET SYSTEM

It has been already mentioned, that a substantive growth of inter-enterprise trade credits and some extent of overruns on the maturity of such credits (arrears) could be expected in all countries that embark on transition to market economy. Some analysts point to the fact that stock and flows of trade credit, on average, are about twice the corresponding amount of bank credit in mature market economies e.g. the United States of America and the United Kingdom (Citrin and Lahiri 1995: 67). Thus the economies in transition by increasing the magnitude of inter-enterprise credit in both absolute and relative terms (in relation to bank credit and GDP) from very low, almost zero levels, are just following the natural path to the more extensive use of inter-enterprise trade credit which is a typical phenomenon of a market economy. So this need not be in itself a reason for undue concern.

However, what has been disturbing is the explosive growth of overdue credits i.e. inter-enterprise arrears, lack of financial discipline and the circumstances under which these arrears arise, reaching proportions that threaten to disrupt the functioning of the whole payments system with considerable damage inflicted on real economy.

In this context it may be mentioned that some Russian analysts reject the notion that the inter-enterprise arrears in transition economies can be seen as an analogy of the category of overdue commercial credit in an established market economy "Nonpayment, including those appearing in the economy of the Russian Federation, are considered by the western experts as an overdue commercial credit. According to our opinion such an approach is not justified, since in the case of these nonpayment one of the main features of credit is missing – voluntariness of its extension." (Afanasjev, Kuznetsov and Isaeva 1995: 53)

Nevertheless the increased use of inter-enterprise credit is likely to become a permanent feature of the economies in transition. The experience of some of these countries such as Poland, Hungary and the Czech and Slovak Republics shows that the phenomenon of inter-enterprise arrears need not acquire critical dimensions, may be just of temporary nature, and can be dealt with by use of market compatible approaches.

B. THE CREDIBILITY OF MACROECONOMIC POLICY AND BEHAVIOR OF ENTERPRISES

At the initial stages of market-oriented economic reforms, liberalization measures are usually combined at the macroeconomic level with tight fiscal and monetary policies in order to stabilize the economy, especially to contain inflation. An integral part of such a policy package is the reduction of bank credit to the business sector. One of the aims of such a tight monetary policy is to promote financial discipline among enterprises, induce them to restructure, and encourage them to substitute internal finance for bank credit. The response of the management of the enterprises (at initial stages of transition) depends on the expectation whether the "credit squeeze" is of a permanent nature or of a short-lived character. In other words, the credibility of the stabilization component of the government policy is at stake and becomes an important factor in determining the enterprises' behaviour, and consequently, is of utmost relevance to the development of inter-enterprise arrears problem.

When the Russian Federation and Central Asian countries introduced stabilization measures in 1992-1993, the SOEs clearly did not perceive these as credible and lasting for a long period of time. Therefore the response was not market-oriented restructuring and increased reliance on own financial resources, but continuation of established pattern of activities.

The liquidity constraint resulting from bank credit squeeze was overcome by resorting to inter-enterprise credit. The willingness of suppliers to tolerate non-payment by their customers stemmed from the expectation that the government would shortly bail them out through reversing restrictive policy and resuming injections of massive credits into the economy. This behavior, called by some analysts "mutual amnesty attitude" resulted in indiscriminatory treatment of partners (both potentially viable and non-viable enterprises) and was a factor in stubborn resistance of the management to undertake necessary structural adjustments to changing market demands (Shmeliev 1995: 28). An accompanying feature was the accumulation of inventories of goods which nobody wanted, however, the survival of firms producing them was made possible by sinking deeper and deeper into arrears.

The expectations about reversal of the government stabilization policies proved to be right when the government of the Russian Federation in 1992, and later also some Central Asian republics governments, reversed the tight monetary policies and dealt with the mounting inter-enterprise arrears problem through multilateral netting exercises accompanied by providing credit to cover the net balance of arrears.

This kind of exceptional measures admittedly brings temporary relief to the "stock" aspect of the arrears problem. However since netting and bailout exercises merely address symptoms rather than underlying causes they become implicitly the factor actually perpetuating and compounding the "flow" aspect of arrears problem by strengthening the expectations of future bailouts of debtor enterprises by the government.

However, looking at the more recent period, there are indications that the situation has changed substantially. At least in the Russian Federation, partly due to the privatization process and also likely due to changing expectations concerning the macroeconomic policies of the government the attitude of enterprises concerning the issue of inter-enterprise credit and arrears has apparently been changing. In this connection it may be of interest to quote from a study on enterprise behavior based on a survey of the sample of 100 firms in Moscow, St. Petersburg, Volgograd, Novosibirsk and Jekaterinburg regions. The authors (Boissien, Cohen and Pontbriand 1995) came to the conclusion that following the inter-enterprise debt crisis of 1992, most firms have switched to a "pay-in-advance" system, whose effect was to lead firms into a "hard budget constraint" economy, far away from what they were used before. As a result the pressure to diversify suppliers, customers and products has been very strong. The enterprises in the sample, irrespective of their size, industry, legal status, etc., all claimed that they request and obtain up-front payment of 80 to 90 per cent of their sales. The only exceptions are well-known, loyal, apparently low risk customers, who are permitted to pay for purchases several days after delivery.

It should be pointed out, however, that the use of prepayment method, though undoubtedly contributing to the financial discipline of enterprises, also has some adverse aspects. In general this rather primitive method places a severe constraint on transactions and could lead to inefficiencies. In some sectors, the nature of business makes it almost impossible to request payments up front. For instance in agriculture, given the perishability of foodstuffs, producers are obliged to deliver goods before being paid. Besides, it has been reported that prepayments lead in some cases to a kind of "perverse" arrears on the part of suppliers who would accept prepayments but then fail to deliver goods on time in agreed quantity and/or quality. The arbitration courts are reportedly flooded with great number of cases of this nature (Krupnov 1995: 9).

C. INADEQUACY OF AND DISTURBANCES IN THE FINANCIAL (PAYMENTS) SYSTEM

Among the factors that considerably contributed to the emergence and intensification of the inter-enterprise arrears problem, the weaknesses and failures in the functioning of the financial system occupy a prominent place. This phenomenon has both international and "domestic" aspects.

1. International aspects

It is beyond doubt that the disruption of the former inter-republican payments system which followed the dissolution of the former USSR was an important special factor which contributed to the accumulation of interstate inter-enterprise arrears in the whole area of the Commonwealth of Independent States. Without going into details it may be mentioned that the break-up of the former rouble zone and so far not much successful efforts to build up an efficient international settlements system adequate for new situation, resulted in resorting to all kinds of second best solutions, including massive use of barter arrangements among enterprises.⁷

⁷ Whatever is said here should not be interpreted as an underestimation of the importance of steps that have been already undertaken by some of the Central Asian countries, the Russian Federation and other CIS countries to establish various types of regional customs, payments and other cooperative structures.

There are no comprehensive data available on interstate enterprise arrears on a multilateral basis, however. Just for the sake of illustration, data on interstate arrears of Russian enterprises are given in table I.3. It appears that enterprises in that country are in general net creditors⁸ vis-à-vis the enterprises in other CIS countries including the Central Asian republics. What is worth noting is the high share of overdue receivables and payables. For example, in case of Kazakhstan, the share of overdue Russian enterprises' claims (receivables) is 67.7 per cent while the share of overdue payments of Russian enterprises to their partners in Kazakhstan is 67.3 per cent, i.e. almost identical. In case of Kyrgyzstan, these shares are 79.6 and 69.1 per cent respectively, in case of Turkmenistan 82 and 70 per cent, etc. Thus one may conclude that in 1994 the arrears were at very high levels⁹ in interstate relations and were being accumulated by enterprises irrespective of their "national" origin.

The disruption of international settlements and accumulation of interstate enterprise arrears had, of course, an impact on the domestic arrears situation in individual countries. For instance, firms that did not get paid in time for their exports could not pay to their local suppliers and often ran up also wage and tax arrears. Or, as in case of Turkmenistan, the huge short-falls in payments for exported gas were taken care of by government subsidies and absorbed by the state budget with negative effects on fiscal and monetary stability.

It is very difficult to make any hard conclusions on the relative importance of disruption in "intra - CIS" economic and payment system within the whole set of factors which contributed to escalation of the inter-enterprise arrears problem to crisis proportions in individual countries. However, one may offer a hypothetical statement that in case of Central Asian republics this effect may have been of greater importance than in case of the Russian Federation, since the CARs' economies were much more "export oriented" towards the former Soviet Union market. At the beginning of 1990s the share of net material products (NMP) exported to the former USSR market amounted to 39.9 per cent of NMP in Kazakhstan, 41.8 per cent in Tajikistan, 43.2 per cent in Uzbekistan, 50.2 per cent in Kyrgyzstan and 50.7 per cent in Turkmenistan. In contrast, in case of the Russian Federation, the exports to the rest of the former USSR represented only 18 per cent of the NMP (Ushakova 1994: 134).

⁸ This, of course, does not necessarily apply to individual enterprises, the totals are to a considerable extent influenced by positions of energy exporters.

⁹ By comparison, the share of overdue payables and receivables of enterprises in the Russian Federation in domestic transactions fluctuated around 50 per cent of total receivables and payables in 1994 [Economic Situation, Russia, 1995 (4)], p. 24.

Table I.3. Russian Federation: interstate inter-enterprise arrears, as of October 1, 1994

(Billions of roubles)

State	Receivables of Russian enterprises from enterprises in the CIS and Baltic countries			Payables of Russian enterprises to enterprises in CIS and Baltic countries			Net receivables	
	Total	Overdue	Share of overdue (per cent)	Total	Overdue	Share of overdue (per cent)	Total	Overdue
Armenia	8.5	4.3	50.2	9.8	2.7	27.8	-1.4	1.5
Azerbaijan	33.9	28.3	83.5	16.4	8.4	50.9	17.5	20.0
Belarus	267.7	158.8	59.3	136.0	66.8	49.2	131.8	92.0
Georgia	21.8	11.1	51.3	9.2	7.0	76.4	12.6	4.1
Kazakhstan	404.8	274.0	67.7	341.5	229.9	67.3	63.3	44.1
Kyrgyzstan	33.9	26.9	76.9	27.8	19.2	69.1	6.1	7.7
Uzbekistan	147.2	92.7	63.0	64.8	36.4	56.2	82.5	56.3
Ukraine	769.8	513.4	66.7	354.5	209.3	57.3	415.4	310.3
Tajikistan	42.4	32.5	76.7	10.2	3.5	33.7	32.1	29.1
Turkmenistan	30.4	24.9	82.0	8.8	6.1	70.0	21.7	18.8
Moldova	42.1	35.1	83.2	14.0	7.9	56.2	28.2	27.2
Subtotal	1 802.9	1 202.4	66.7	993.2	591.2	59.5	809.7	611.3
Latvia	36.9	18.7	50.7	9.7	4.2	43.2	27.3	14.5
Lithuania	28.3	11.0	38.8	18.2	4.0	22.0	10.2	7.0
Estonia	46.2	17.5	37.8	26.0	4.7	18.3	20.3	12.8
Total	1 914.5	1 249.6	65.3	1 047.1	604.1	57.7	867.4	645.6

Source: International Monetary Fund, *Policy Experiences and Issues in the Baltics, Russia, and Other Countries of the Former Soviet Union*, edited by Daniel A. Citrin and Ashok K. Lahiri (Washington D.C., December 1995), p. 67.

Note: CIS consists of the Russian Federation and the other states of the former Soviet Union, except the Baltic states.

2. Domestic aspects

There is almost a general agreement that in the initial stages of transition to market economy, supply and quality of financial services fall far short of demand. Enterprises thus have to organize financial arrangements among themselves to sustain trade and output. In the conditions of uncertainty, suppliers often assumed high risks that resulted in accumulation of inter-enterprise arrears. The banking system, itself undergoing a substantive transformation, was often a source of considerable delays in the payment settlements. Under the newly emerging market system, payments orders could be executed only after clearing, and lack of adequate computing and communication facilities led to inordinate delays in effecting payments. It was not exceptional that payment order could take as long as three months to be executed (Citrin and Lahiri 1995: 69). The disintegration of large enterprises into many autonomous units that took place in the Russian Federation and some of the CARs, also may have contributed, by increasing overall credit needs of enterprises and the volume of transactions in the economy. All this was undoubtedly contributing to the intensification of the process of accumulation of inter-enterprise arrears.

It should be also mentioned that under the conditions of high inflation and high nominal (and at times also real) interest rates the banks are very much stimulated to extend the time needed for settlements in order to maximize the amount of resources at their temporary disposal, partially free of charge. This phenomenon of the so called "float" within the banking system which could be observed also in the Russian Federation and other CIS countries has been one of the factors aggravating the inter-enterprise arrears problem.

However, one should note that the situation has been fast changing. For example, concerning the Russian Federation, one of the recent studies came to the conclusion that by the end of 1994 "... the central bank and commercial banks improved payments system substantially to a level largely comparable to the international standard although some inter-regional settlements continued to lag. As a result, no enterprises could accuse the payments system of responsibility for overdue payments." (International Monetary Fund 1995: 16)

The improvement in the payments system was also partly due to the series of measures by which the government of the Russian Federation reacted to the resurgence of arrears accumulation in 1993 and 1994. The government issued a number of normative acts aimed to monitor arrears positions, clarify payment procedures and strengthen

payment disciplines. For instance, "File No. 2" was reintroduced in the banking system in October 1993 to measure the arrears position of firms.¹⁰ In addition, payment priorities were established for various obligations, and firms were obliged to sell foreign currency deposits to settle overdue payments, according to a presidential decree of May 1994.¹¹ Another presidential decree of the same month prohibited each enterprise from keeping more than one rouble settlement account with resident banks as a way to facilitate monitoring of firms' compliance with the May 1994 decree.¹² Also, in May 1994, the Federal Bankruptcy Commission under the State Committee for the Management of State Property (GKI) set up specific bankruptcy criteria which included the size of overdue debts relative to liquid assets.¹³ The commission has identified thousands of potentially bankrupt firms, and enterprise managers began to face an increasing threat of losing jobs. Managers were to be personally responsible for violation of regulations on payments and accounting disciplines, and a manager of "Norsi", an oil refinery company, was fired in the summer of 1994 as the first prominent case (Troparevskaya 1995: 11).¹⁴

Increased concern with the renewal of the rising trend in the amount of inter-enterprise arrears in 1994 also led to the creation of a special Government Commission under First Deputy Prime Minister to explore the ways to resolve the problem.

10 Presidential Decree No. 1662 of October 19, 1993 "On improvements in settlements in the national economy and their timely executions to increase accountability."

11 Presidential Decree No. 1005 of May 23, 1994 "On additional measures to normalize settlements and strengthen the payment discipline in the national economy". In a move to implement the decree, the Central Bank of the Russian Federation (CBR) established an interim procedure regarding how legal entities might use funds in their settlements and current accounts (CBR letter of June 30, 1994, No. 98). Also, the State Tax inspection, the Ministry of Finance, the CBR and the Ministry of Justice issued a resolution to support the decree (Government Resolution No. 682 of September 8, 1994).

12 Presidential Decree No. 1006 of May 23, 1994.

13 Government Decree No. 498 of May 20, 1994.

14 It should be mentioned that some of these measures were subject to criticism by some Russian analysts who maintained that they are based on wrong assessment of causes of accumulation of inter-enterprise arrears. The critics claimed that the measures seemed to assign the major role to the misbehaviour of managers of enterprises and did not appreciate the objective factors which brought the enterprises into critical financial position. Some of the measures were allegedly in the nature of "free hunting of directors of enterprises".

D. DEFICIENCY OF THE LEGAL AND INSTITUTIONAL STRUCTURES

The starting point of the transformation toward market-based system in all economies in transition, including those of the former Soviet Union, was marked by one common feature: the absence of laws and institutions necessary for the smooth functioning of a market economy.

In regard to the arrear issue, it is relevant to point out that accurate and meaningful financial statements, clearly defined property rights, and a legal system with full powers of enforcing contracts are necessary for the proper functioning of the loan market and limiting loan delinquencies. In a functioning market economy, failure to service a loan obligation on time affects future access to credit, and ultimately involves the threat of bankruptcy. Enterprises in a market economy do not incur arrears when the costs of incurring them are high and it is the legal and institutional framework which is crucial for determining the costs.

With certain degree of simplification it can be said that in the Russian Federation and Central Asian countries, the above mentioned conditions for financial discipline were not present. On the contrary, the enterprises did not have accurate and meaningful balance sheets or profit - and - loss statements. Property rights were not clearly defined and there were no bankruptcy laws to fully enforce contracts. Thus, there were no ways to assess properly the credit risks, and, at the same time practically no sanctions for not paying the inter-enterprise debts on time. The managements of both SOEs and privatized or newly established private companies thus behaved in a "rational" way; in an effort to survive and/or maximize short term gains they took advantage of the loopholes in legal and institutional framework. The lack of financial discipline thus became a widespread phenomenon.

The lack of regulatory measures and discipline was, *inter alia*, reflected in such phenomena as enterprises not paying to their suppliers because of financial "strain", while at the same time converting their financial resources into foreign exchange assets (sometimes through "capital flight" abroad) and/or using them for short-term speculative gains. It is beyond the scope of this paper to go into a broader context of the impact of the lack of legal regime on the economic life in general. However, taking even a limited view of the impact of this deficiency, especially the lack of legal mechanisms for enforcing the contractual payment obligations, it can be observed that not only has there been the shift to pre-payments, but also very extensive use of cash in business transactions was resorted to. The use of cash, of course, increases transaction costs by, *inter alia*, increasing security risks, inviting crime and

ultimately causing additional expenditures on security guards etc. At the same time the lack of capacity¹⁵ to enforce the contracts, in particular repayment of debts, gives rise to a special industry – setting up of firms specialized in getting the debtors to pay their debts.

As already mentioned, one of the main deficiencies of the legal and institutional systems which was at the root of lack of financial discipline and aggravated the inter-enterprise problem was the absence of effective sanctions against defaulting debtors was the absence of bankruptcy laws and/or capacity to enforce them.

However, it should be pointed out that considerable progress has been achieved in creating the legal framework. In the Russian Federation and all the Central Asian countries, the bankruptcy laws were adopted and/or revised in 1992-1995 period. Although their implementation is still at a rather initial stage, in some countries the number of cases of bankruptcies has been recently increasing. It has been observed that even a mere threat of bankruptcy contributes to the strengthening of the payments discipline and alleviation of the inter-enterprise arrears problem.

¹⁵ It is not only a question of providing adequate laws but also the capacity to enforce them. Here, the limited capacity of courts proved to be often the main bottleneck in ensuring the exercise of creditors' rights.

III. CONCLUSIONS AND POLICY RECOMMENDATIONS

The first conclusion that may be drawn from the discussion in the preceding sections is that the inter-enterprise arrears problem is the outcome of a very complex set of interacting causes and factors. It is also a phenomenon which is closely interrelated with other types of arrears (defaults in payment to banks, tax and wage arrears) and is influenced by macroeconomic environment shaped by monetary and fiscal policies. Dealing effectively with this problem thus cannot rely on the application of only some special, narrowly conceived measures.

However, ultimately it is the behaviour of the microeconomic agents and enterprises which determines the evolution of inter-enterprise debt and of eventual arrears. Thus inter-enterprise arrears can only be contained on a sustained basis by ensuring that enterprises adjust to the emerging market system and observe financial discipline. A stable macroeconomic framework and a structure of appropriate incentives are essential in this regard and can be achieved only by the steadfast pursuit of strong stabilization policies and accelerated structural reform.

As has been pointed out, high inflation provides a powerful stimulus to enterprises to sink deeper into arrears. Therefore, it is of vital importance to continue with the efforts to contain inflation. In this regard, the Russian Federation and the CARs have recently achieved a considerable progress. For example, in the Russian Federation annual inflation rate was reduced from 896 per cent in 1993 to 190 per cent in 1995, monthly inflation rate fell to 3-4 per cent in early 1996. Kazakhstan achieved even sharper reduction of annual inflation rate from 1,160 per cent in 1994 to 60 per cent in 1995 with monthly inflation rate running at 2.5-4 per cent in early 1996. Kyrgyzstan was the first among the CARs to succeed in containing inflation to moderate level of 87 per cent in 1994 and further reducing it to 30 per cent in 1995 and was experiencing monthly rates at 3.6-3.8 per cent in early 1996. Also in Armenia the drastic reduction of annual inflation rate from 1,884 per cent in 1994 to 32 per cent in 1995 took place. In Uzbekistan annual inflation rate was reduced from 1,281 per cent in 1994 to 110-115 per cent in 1995. In Azerbaijan monthly inflation fell to an average of about 3 per cent in the last quarter of 1995 – and then to

1.5 per cent in the first quarter of 1996 from more than 50 per cent per month at the end of 1994. Tajikistan was the only exception to this general trend with annual inflation rate reaching a hyperinflation level of 2,223 per cent in 1995.¹⁶

To continue with this positive anti-inflationary trend, it is advisable to avoid the application of exceptional policy measures to deal with inter-enterprise arrears which might rekindle inflation. In view of the past experience the multilateral netting out exercises accompanied by government credit to cover net arrears should not be repeated. This is of vital importance also for instilling financial discipline in enterprises which must accept responsibility for their own indebtedness as well as for the consequences of too careless extension of credits to customers.

This does not mean that bilateral and in some exceptional cases multilateral schemes of netting out of the stock of arrears cannot serve a useful purpose. However, these must not be accompanied by credit creation and should not lead to expectations that such netting out operations would become a repetitive feature.

However, the accumulated stock of enterprise arrears is a burden which cannot be left unattended. In this connection it may be worthwhile to quote the relevant recommendation in a recent International Monetary Fund publication: "The resolution of the stock problem should be achieved by encouraging debtors to reschedule their overdue payables through voluntary bilateral contacts with creditors. In addition, enterprises should be encouraged to securitize their inter-enterprise claims to make them tradable: an enterprise in need of liquidity could sell an inter-enterprise claim at a discount to another firm; the buyer could then either hold the claim or set it off against its own liabilities to the original debtor firm (on whom it now owns a claim), if such liabilities exist. Banks could also become involved in this activity, purchasing and selling securities subject to normal prudential regulations. The opportunity for profitable trade in inter-enterprise claims in a market environment should help resolve the problem of arrears. Development of requisite safeguards to prevent insider trading and other manipulative practices in the securities market should proceed in parallel with the securitization of claims.

¹⁶ All data in this paragraph are taken from relevant issues of the *IMF Survey* and from OECD, *Short-term Economic Indicators* (April 1996). Recent data on Turkmenistan were not available in these sources.

In the short term, governments and central banks can promote a solution to the "stock" problem of existing inter-enterprise arrears by promoting decentralized bank-enterprise debt workouts with a menu of options, as well as a secondary market where arrears could be traded. Such an approach could lead to a netting out of inter-enterprise arrears without any extension of government or central bank credit, and send a strong signal to enterprises and banks that the authorities will no longer bail out firms with arrears of bad debts, thereby promoting the restructuring process through the adoption of hard budget constraints.¹⁷

The involvement of governments and central banks should be limited to providing an adequate regulatory and institutional framework, for example, regulations that appropriately govern trading in inter-enterprise credits. Rules allowing limited forms of multilateral netting, whereby a group of firms form an arrangement to net out debts within the group, should also be considered. In any event, market-based solutions are unlikely to work without some credible threat of bankruptcy for notorious delinquencies, and there should be no government guarantees for the securities." (Citrin and Lahiri 1995: 72) Let us add that this line of action can lead to debt for equity swap operations through which the creditors acquire stake and sometimes controlling position in indebted firms.

Turning now to the task of preventing the emergence of new inter-enterprise arrears (the so-called "flow" aspect), it has been already mentioned that it is of crucial importance to create the environment providing strong incentives to enterprises to restructure in response to the market needs, to take full responsibility for their inter-enterprise creditor/debtor relationships and to exercise financial discipline. At a more general level, two lines of policy measures are involved here: privatization and restructuring of SOEs by exposing them to the "hard budget constraint". Without going into details let us quote from a recent World Bank publication: "In sum one of the strongest messages from transition to date is that the governments that enforce financial discipline and foster competition will stimulate restructuring of enterprises, regardless of ownership". (World Bank 1996: 47)

In this context, among the policy measures of direct relevance to inter-enterprise arrears problem is the adoption of bankruptcy laws and procedures. This is a powerful instrument for strengthening financial discipline, facilitating restructuring (including eventual closing of non-viable entities), and, at the same time, promoting flow of credits to potentially viable enterprises by protecting the creditors' interest. In the

¹⁷ The approach played a part in the restructuring of enterprise debt in Poland.

Russian Federation and all the CARs the bankruptcy laws have been adopted. However, it will take time before the increased capacity of judicial courts and availability of trained liquidators make the bankruptcy procedures work smoothly and effectively alter enterprises behavior.

Until this happens the governments should take an active role in restructuring process. It is suggested that the government should identify a narrow set of enterprises responsible for a large proportion of the arrears. After monitoring these enterprises for a clearly defined period, the government should decide on their long-term viability. If they are deemed to be not viable, then bankruptcy proceedings should be initiated by the government. In exceptional circumstance, if bankruptcy is not a viable option for a particular enterprise because of strategic considerations, the flow problem should be dealt with by restructuring the enterprise and identifying budgetary support over the medium term. Furthermore, it is important to make the provision of budgetary support conditional on, *inter alia*, the clearance of existing arrears and their avoidance in the future.

Some of the CARs have been involved already in this type of exercise. For instance, in Kyrgyzstan, 29 firms were assigned to be restructured under the guidance of government "restructuring agency". Over a 24-month period eight have been liquidated (including a 5,000 – employee agricultural machinery plant that the government had regarded as strategic), two have been sold, six more are for sale, eleven are being downsized in the hope of rendering them salable, and two are still in the diagnostic stage. So far the exercise has cost around US\$ 20 million, of which half went to cover arrears on energy payments and much of the remainder to provide severance payments for more than 40,000 dismissed workers. It is argued that both the information supplied by external consultants and the provision of money to pay for severance costs have been crucial in persuading the Kyrgyz authorities to act (World Bank 1996: 48).

The above mentioned issue is related to a more general question of the appropriate role of the government in shaping up structural changes in economy in transition. In other words, the desirability of the government to pursue an active industrial policy is at stake. In the opinion of this author, there are strong arguments for applying a "market friendly" industrial policy complemented with science and technology and export promotion components. The experience of Japan and of the Asian newly industrialized economies can be very useful in this area for all transition economies.

Coming back to the issues of more direct relevance to inter-enterprise arrears problem let it be mentioned that in the efforts to improve the financial discipline – besides already mentioned systemic and

technical measures – it is of vital importance that the governments set the example. So there is a need for governments to clear any arrears for which they may themselves be responsible. The dimensions of this may be quite significant – for example, it was reported that in the Russian Federation two-thirds of the amounts due to enterprises from government were in arrears in mid-1994. Such a stance undermines discipline in the rest of the economy, having in addition very serious social consequences. The governments should give top priority to measures to redress and prevent such situations.

It has been already mentioned, that, on the other side, the most disturbing element in overall arrears pattern is the increasing magnitude of tax arrears. Here the solutions should be sought primarily in improving the tax administration and efficiency of tax collection provided that the market-oriented tax reforms have been already implemented. Recently the Government of the Russian Federation introduced a measure to deal with the tax arrears problem which is worth noting for its rather innovative approach. This is embodied in the Presidential Decree No. 65 of January 19, 1996 which aims at achieving two seemingly contradictory objectives: first, to improve the financial position of enterprises and organizations, and, second, to strengthen the discipline of payments of taxes and other compulsory contributions into the budget and extra budgetary funds.

The approach consists in granting to enterprises and organizations the deferment of their payments of the tax and other arrears accumulated as of January 1, 1996. If the deferment is granted by the respective tax administration office (the enterprise/taxpayer has to provide reason for not being able to pay on time; e.g. financial constraint which would result in discontinuation of production), the rescheduling is done in the following manner: 50 per cent of the amount owed has to be repaid in equal quarterly installments within two and half years (up to October 1, 1998). Interest charged on the amount outstanding is 30 per cent per year which means that the government is extending credit to the taxpayer on very soft terms. After the repayment of the first half of indebtedness, the tax office may grant another deferral covering the rest of the taxes owed. In this case the terms are even softer: repayment within 5 years and no interest charged (Smirnov 1996: 3).

It sounds, of course, as one of the many ways of subsidizing faltering enterprises. However, the innovative feature consists in the strict application of conditionality principle: only enterprises and organizations that meet fully and on time their tax and other obligations are eligible for the above described rescheduling of accumulated tax arrears. If the enterprise fails to pay current taxes on time the deferment is cancelled and all the penalties and sanctions come into force immediately. The approach applied in Presidential Decree No. 65 can thus be described as

“soft treatment” of the issue of the stock of tax arrears in exchange for, or conditioned by, observing strict discipline in regard to current tax payments. It remains to be seen how this combination will work in dealing with tax arrears problem.

The strong link between the evolution of inter-enterprise arrears and the credit policy has been quite obvious: whenever in the past the credit squeeze appeared, enterprises turned to inter-enterprise credit and running up arrears. It was already pointed out that solution cannot be anymore looked for in government resuming expansionary credit policy. What should be aimed at, is the commercial banking sector reform and development, which would not only provide smoothly working payments system for inter-enterprise transactions but also offer a broad range of bank credit. An important element in this process is to create conditions and regulatory frameworks for market determined interest rates on all kinds of credits and deposits. This is vital for coming closer to the rational proportion between the use of bank loans and inter-enterprise trade credits and for the alleviation of undue accumulation of inter-enterprise arrears.

Before concluding let us briefly comment on the issue of resolving the interstate inter-enterprise arrears problem. It was pointed out that interstate arrears contributed significantly to the increase of inter-enterprise arrears in both the CARs and the Russian Federation. In dealing with these arrears it is important to distinguish between those that were, especially in the past, incurred by state enterprises operating under inter-governmental trade agreements, and, other types of arrears incurred by enterprises on the basis of their own free decisions. The governments should take responsibility for the first type of inter-enterprise arrears, and work out mutually acceptable solutions at the inter-governmental level. The inter-enterprise arrears resulting from autonomous firms' operations should be left to be resolved by enterprises themselves without any involvement of the governments. However, for resolution of the past stock of this type of interstate inter-enterprise arrears as well as for efficient intermediation of current trading operations it is vital to ensure free access to foreign exchange for the business sector. It is, of course, the responsibility of governments to devise appropriate foreign exchange regimes.

At the very end, it may not be out of place to quote Adam Smith, whose thoughts may be of some relevance to the topics discussed in this paper: “Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay.” (Smith 1937: 862).

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**RENEWAL AND DEVELOPMENT OF
ECONOMIC COOPERATION BETWEEN THE
RUSSIAN FEDERATION AND THE
CENTRAL ASIAN COUNTRIES***

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I. ECONOMIC INTERDEPENDENCE OF THE COUNTRIES IN THE FORMER SOVIET UNION

The rapid disintegration of the Soviet Union has created such economic problems that it will undoubtedly take not years but a few decades or even the lifetime of two or three generations to overcome them. This is obviously the case in the Russian Federation. However, it is even more evident in other former Soviet republics including the newly-independent Central Asian states – Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan and Turkmenistan.

In fact, the degree of integration and interdependence of national economies of the former Soviet Union was much higher than, for instance, in the European Union (EU). In the former Union of Soviet Socialist Republics (USSR), the inter-republican turnover accounted for 20 per cent of GNP in 1990, while in the EU countries this figure reached only 14 per cent. At the beginning of the 1990s the share of the net material product supplied by the former USSR to other Soviet republics was 39.9 per cent for Kazakhstan, 50.2 per cent for Kyrgyzstan, 43.2 per cent for Uzbekistan, 41.8 per cent for Tajikistan and 50.7 per cent for Turkmenistan as compared to 18 per cent for the Russian Federation (Ushakova 1994).

During the past decades the economies of the former Soviet states had become an integral part of the common economic complex (whether viable or not is another question). Naturally, the rupture of traditional economic ties was extremely painful for all. It was estimated that the total breakdown of industrial production in all Commonwealth of Independent States (CIS) – at least during the first two years after the disintegration of the former USSR – was mostly caused by disruption or even total termination of long-established inter-republican trade and cooperative relations (Plyshevsky 1994). However, despite the drastic decline in production and trade turnover among the CIS, the individual economies retained basic orientation to the Russian Federation: that country was and remains the major external supplier and the primary market for all new states.

Looking back, one may certainly and with good reason state that the Soviet-era system of inter-republican division of labor and location of enterprises was utterly unsound. It was partly caused by miscalculations in centralized planning and administrative and political arbitrariness of central authorities, but the main reason lay in the basic economic mechanism, particularly in deeply embedded distortions of the pricing system existing in the former Soviet Union that misrepresented beyond recognition all normal pricing considerations. As a result, the principle of "comparative costs" with regard to location of enterprises in the economy of the former Soviet Union was ignored. In 1991, for example, in the former USSR the level of domestic prices, as compared to world prices, was 13 per cent for oil, 9 per cent for gasoline and diesel fuel, 3 per cent for natural gas, 5 per cent for fertilizers, 6 per cent for cement, 17 per cent for timber and 25 per cent for ferrous metals (International Union of Economists and the Free Economic Society of Russia 1995: 132). This was accompanied by greatly (often 2-3 times) inflated prices for machines and equipment and for industrial consumer goods as well as non-existence of prices for land, water and many other things, distorting both capital and current costs and leading to inappropriate choice of industries and their locations.

Energy-intensive industries were located at enormous distances from the main sources of energy in the Russian Federation while cotton-processing industry, in defiance of all common sense, was concentrated not in Uzbekistan, Tajikistan and Turkmenistan where it was most appropriate to locate it, but in the European part of the Russian Federation. All those oil fields, mines, ore-dressing plants, engineering factories, pipeline, etc. employed hundreds of thousands or millions of workers and could not be closed at will. Actually, many of them should not be closed at all but just modernized and restructured. This, however, also takes time and substantial resources.

Apart from narrow inter-republican specialization, which often bordered on monopoly, the interdependence of the former Soviet republics was further reinforced by endless subsidies from the Russian Federation to other republics that lasted for decades. There were open subsidies in the form of centralized budgetary payout and preferential or often non-interest bearing credits as well as hidden subsidies in the form of a tremendous gap between internal and world prices for energy and raw materials supplied from the Russian Federation. In 1988, for instance, the balance of payments between the Russian Federation and other republics calculated in terms of world prices and in US dollars would have been a surplus in favour of the Russian Federation exceeding US\$ 51 billion, with Kazakhstan accounting for US\$ 11 billion,

Uzbekistan – almost US\$ 5 billion, Kyrgyzstan and Tajikistan – US\$ 1.8 billion each, while only Turkmenistan would have an equal balance in that year (Commission of the European Communities 1990: 79). It should also be noted that just before the disintegration of the former USSR the share of direct subsidies from the All-Union budget varied from 20 per cent (Turkmenistan) to 45 per cent (Tajikistan) of the republics' budgetary expenditures (Shishkov and Yevstigneyev 1996: 59).

But even when the liberalization of the Russian Federation's economy began and subsidies to other republics through prices were reduced, more than 10 per cent of GDP of the Russian Federation in 1992 was spent on providing assistance to the CIS countries primarily in the form of so-called "technical" (actually meaning non-interest and – nonreturnable) credits and supply of roubles in cash. "Technical" credits and cash supplies from the Russian Federation to the Central Asian countries in 1992 amounted to 25.1 per cent of GDP in Kazakhstan, 69.2 per cent in Uzbekistan, 22.6 per cent in Kyrgyzstan, 67.1 per cent in Turkmenistan and 42.3 per cent in Tajikistan. The corresponding figures for the first seven months of 1993 were 48.8 per cent for Kazakhstan, 52.8 per cent for Uzbekistan, 23.9 per cent for Kyrgyzstan, 45.7 per cent for Turkmenistan and 40.9 per cent for Tajikistan (Delovoy Mir 1993). Shortly afterwards it became perfectly clear that there was no other source in the world that could even come close to matching the amount of such subsidies.

Of course, this historic legacy cannot be overcome within a short period of time despite proud political postures taken by leaders of some CIS countries. Self-sufficiency and economic autarkies are not feasible for the Russian Federation either today or tomorrow and absolutely impossible for all other CIS countries. As estimated by academician A. Granberg, in a hypothetical situation of total economic isolation, the Russian Federation would be capable of producing output equivalent to 64.5 per cent of its actual final product, Azerbaijan – 31 per cent, Kazakhstan – 28.1 per cent, Ukraine – 14.8 per cent. In some other countries, such as Moldova and Armenia, autarky would have resulted in the collapse of the economy in terms of satisfaction of final needs (Russian Academy of Sciences 1992: 13). According to the study of economic viability of the former Soviet republics conducted by the experts of "Deutsche Bank", Kazakhstan received 55 points out of a maximum of 120, Uzbekistan – 32, Turkmenistan – 27, Kyrgyzstan – 24, Tajikistan – 18 (Zagashvili 1994: 57).

Years that have passed after the dissolution of the former USSR have confirmed that the apparently effortless rupture of deep-rooted ties between its former republics was only illusory. Though crippled by acute

crisis, the common post-Soviet economic space still remains, though the modalities of its functioning have changed dramatically and continue to change. Russian political analyst D. Furman was correct in noting that now the majority of the former Soviet republics are much less viable than is implied by their independent status, while the economic space is much more united and differently organized in reality than formally (Furman 1996). In the immediate future complete reorientation of economic ties toward other geographic directions is impossible for the CIS countries (with very rare exceptions). Even in the medium term, it would not be easy, taking into account the harsh realities of international competition and limited industrial, scientific and technical capabilities of these states.

II. CAUSES OF DISINTEGRATION

A legitimate question may be asked: why, with such deeply-rooted economic integration of the former Soviet republics, has the breakup of the united economic complex into numerous semi-independent, structurally disproportionate national entities become possible? Why the CIS is not capable of retaining a high degree of mutual adaptiveness and interpenetration of republican economies which was ensured from above, by administrative planning methods in the former Soviet Union?

It seems that this happened exactly because the former Soviet system of integration was based on administrative planning without any trace of market relations. If the former Soviet republics were interrelated not through centralized directives but through market forces (at all levels of integration) the economic collapse would not have occurred. A well-known Russian economist Y. Shishkov noted that in a centrally planned economy, relations between economic entities within states are regulated by command and distribution mechanisms and between states – by a quasi-market mechanism. If the Soviet economy had been market-oriented, the transfer of various regions under the jurisdiction of several sovereign powers would not have caused substantial disruption of economic ties (Shishkov 1993).

Lack of market-based relations and completely distorted price structure under the administrative planning system were the fundamental reasons even for initial, purely political thrust toward the dissolution of the former Soviet Union. Ambitious nationalist leaders from the very start sought (and found) the popular support in their republics using just one argument: the Russian Federation exploits other republics; suspension of supplies and breakup of economic relations with it should almost immediately raise the well-being of all the former Soviet provinces. It did not take much time to see that reality was quite the opposite and the sharp price disparity was (and to some certain extent still remains) in favour of the CIS countries, not the Russian Federation. The situation was aggravated by the desire to grasp the largest possible portion of all-Union property which accounted for more than 50 per cent of all capital assets in the former Soviet Union republics, the naive and short-sighted efforts to close one's market to neighboring countries under conditions of chronic shortages, and unfounded hopes regarding access to international aid.

Some time ago, the CIS countries tried to organize mutual exchanges according to the old Soviet model, i.e. with emphasis on bilateral (and sometimes multilateral) intergovernmental agreements on guaranteed supplies of major products. However, these attempts failed. The old system of distributing products by government command had been dismantled not only in the Russian Federation but in all the post-Soviet states. What seemed to be appropriate and feasible in view of the Government of the Russian Federation or governments of other CIS countries turned out to be either impracticable or unprofitable for producers who broke free from rigid state controls and tried to adapt to market conditions.

Usually, there are three categories of export-import flows under bilateral intergovernmental agreements within the CIS: compulsory supplies, indicative supplies and free trade between enterprises of corresponding countries. The first category comprises about 100 most important types of energy sources and raw materials which states undertake to supply to each other in agreed quantities and, as a rule, at mutually acceptable negotiated prices. The second one comprises 1,000-1,500 items of goods, including machines, equipment, consumer goods, foodstuffs; the volume of their supplies is agreed upon at governmental level but the real exchange of goods takes place on contractual basis between direct suppliers and buyers. If these microeconomic entities fail to agree upon prices and credit conditions, quotas on competitive goods agreed upon between governments might remain (and do remain) unfulfilled. The third group comprises all other goods which can be freely exchanged between microeconomic entities without government's brokerage. It should be stressed that today 70-75 per cent of export-import transactions between the Russian Federation and the CIS member states are already effected through direct ties between enterprises (Institute of World Economic and Political Research 1995). Unfortunately, much too often it takes the most primitive form: it was estimated that direct barter arrangements accounted for at least 70 per cent of the total volume of mutual trade between the CIS countries (Afanasjev 1995).

Since 1991, this semi-administrative, quasi-market system of mutual economic relations has experienced all natural consequences of protracted economic crisis on the post-Soviet territory. Compulsory supplies of oil and oil products, natural gas, ferrous and nonferrous metals, cotton, grain, etc. were never effected in those years for more than 25-50 per cent of agreed upon volumes; initiatives at microeconomic level were not able to offset the shrinking traditional scope of cooperation. There are various underlying reasons for this but they all have one thing in common – hard and painful transition from administrative planning system to market-based criteria and incentives.

Some of the consequences of the disintegration of the union and transition to market economy were a general decline in output and the resulting reduction of supply and contraction of markets, skyrocketing commodity prices and transport tariffs which are approaching the world level; different dynamics and levels of internal prices sometimes with differences as high as 15-20 times between various CIS countries; different scope and pace of privatization and, consequently, varying situations of the private sector and entrepreneurship; customs, tariff and currency wars waged between the CIS countries; large-scale defaults of payment and tremendous growth of mutual debts (the CIS countries owe the Russian Federation more than US\$ 9 billion; the debt of Ukraine to Turkmenistan alone for natural gas deliveries amounts to US\$ 1 billion); severe third country competition in both export and import (the CIS share in the Russian Federation's foreign trade has decreased during the years of reform from more than 60 per cent to 22-24 per cent); and the unforeseen large-scale migration of the most qualified labor and educated population from a number of countries, including Central Asia; etc. All these and many other painful changes of the recent years dramatically testify to the fact that there is not and cannot be an isolated "island of prosperity" within the post Soviet space while close neighbors and partners suffer from acute crisis. This holds true for both state or semi-state (privatized) sector of the economy and private enterprise. For instance, where can fruit and vegetable producers from Uzbekistan find a replacement to the Russian Federation's market which in former times absorbed the greater part of their products? (Abazov 1996).

It seems that the growing "asynchronicity" – to use the term coined by Russian political analyst Y. Zhilin – of economic reforms in the CIS countries is the major obstacle to maintaining and developing stable relations within the post-Soviet space (Zhilin 1994: 71). Increasing divergence of their economic systems can be traced in almost every aspect. It is particularly evident in different attitudes of the CIS countries toward the problem of structural adjustment of their economies, the need to eliminate unprofitable production and, consequently, in different fiscal and monetary policies.

As was correctly noted by the Russian economist V. Kirichenko, the process of restructuring production and adjusting the economic system, changing trade and geographic pattern of external relations and putting an end to the exclusive orientation toward the CIS economic space is inevitable (Kirichenko 1994). Today, inflation rates within the post-Soviet space vary from recent 100 per cent in the Ukraine to 1 per cent in Estonia (Shmeliev 1994). Such variations are determined mostly by the degree of budgetary support used by governments to prop up unprofitable and nonviable enterprises in the economies. In other words, Ukraine, Belarus, Kazakhstan, Uzbekistan, Tajikistan, Turkmenistan are still trying

to provide budget support to almost all of their industrial enterprises, sectors and regions. The Russian Federation is trying to pursue selective policies, though with little success. The Baltic republics (especially Latvia and Estonia) seem to have made up their mind to leave the whole industrial sector and a large part of agriculture without any budget subsidies. It is obvious, however, that inflation rates influence the possibility of proper payments and, consequently, effective trade between the former Soviet republics as well as the prospects for full convertibility of their national currencies.

A purposeful policy of "repulsion" that was actively pursued by the Russian Federation since 1993 played an important role in the breakup of the former system of economic relations. In 1992, for instance, "technical" credits provided by the Russian Federation to support its trade turnover with the CIS countries accounted for 69 per cent of the total volume of the Russian Federation's export to these countries (in other words, the Russian Federation paid the same amount for its own export). In 1993, this figure decreased to 12 per cent, in 1994 – to 1.5 per cent, and in 1995 new credits for these purposes were not even envisaged in the budget (Kirichenko 1995).

Such a twist in the policy of the Russian Federation is quite understandable: the Russian Federation's economy was in deep crisis and was not capable of providing donor assistance to other CIS states at the same level. It was also for the same reason that the Russian Federation, having issued the "new rouble" in June 1993, practically "pushed" Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan and some other countries out of the "rouble zone" which, naturally, caused serious, albeit justified, damage to them. In fact, all other measures taken by the Russian Federation with regard to the CIS countries (Belarus being the only exception) were aimed at turning the "near abroad" into "far abroad" by changing terms of trade, prices, payments and currency exchanges.

This entailed especially grave consequences for the Central Asian countries in view of the magnitude of the challenges they were facing. Among those challenges one should underline, firstly, the need to overhaul the old distorted production structures and finding a new industrial specialization; secondly, urgent measures to expand and diversify the export sector which alone could provide resources for structural adjustment; thirdly, creation of jobs and reduction of unemployment, especially in agriculture; and finally, solution of profound environmental problems, primarily that of the Aral Sea (which could cost, according to some estimates, at least US\$ 40 billion). The scope of these tasks requires huge external financial and technical assistance and with other external sources of financing being limited, it is hard to expect that these problems will ever be solved without the Russian Federation's involvement.

The situation was further aggravated by the fact that interest of "third countries" toward Central Asia has proved to be motivated by political rather than economic considerations. As suppliers, the Central Asian countries attract the attention of investors from the developed countries only in the oil and natural gas sector and to a certain extent – in metallic ore and precious metal mining. As a sales market, Central Asia is even of less interest to partners from "third countries" taking into account its low purchasing power. Central Asian states were quickly disillusioned with regard to the real prospects for cooperation within the framework of the Economic Cooperation Organization led by Turkey. Hopes for massive flows of dollar assistance from leading developed countries and international financial institutions have not been realized. Finally, the so-called "common market" of Central Asian states is not dynamic enough because of national economic structures of its members that often duplicate one another; the volume of mutual trade between these countries is still much smaller than the volume of their trade with the Russian Federation.

Of course, this does not mean that new geographic directions of cooperation for Central Asia are hopeless. They play an important and increasing role: for example, Kazakhstan directs one-fourth of its export to China while the completion of a gas pipeline from Turkmenistan via Turkey to Europe will undoubtedly change this country's situation in terms of foreign currency inflows and its capacity to modernize the economy. However, in the foreseeable future these new directions for cooperation can only complement but not exclude the cooperation with other CIS countries and, first and foremost, with the Russian Federation.

New partners of Central Asian republics would hardly be able or willing to solve their main problems today – how to preserve at least the most viable part of the existing capacity in the manufacturing industry, how to ensure the "breakthrough" into the sphere of high technologies and how to protect and expand their educational, scientific and technical base. This problem is a legacy of the former Soviet Union era and will most probably be solved within the post-Soviet space.

It could be argued that the period of strengthening political independence coupled with economic disintegration has not brought any economic or social dividends to the CIS countries. After a dramatic fall of gross national product and industrial production in all CIS countries in 1992-1994 by 40-70 per cent, even a relatively good year of 1995 did not bring any relief. As indicated in table II.1, GDP and industrial production in Kazakhstan fell by 8.9 and 7.9 per cent respectively in 1995, in Kyrgyzstan – by 6.2 and 12.5 per cent, in Tajikistan – by 12.4 and 5.1 per cent; Uzbekistan's GDP fell by 1.2 per cent and the industrial production of Turkmenistan – by 6.9 per cent (International Fund 1996: 8). In 1995,

Table II.1. Central Asian economies: summary of macroeconomic indicators, 1991-1995

(Percentage of the previous year)

		GDP	National income	Industrial production	Agriculture	Investment	Retail trade turnover	Consumer price index (times)
Kazakhstan	1991	88.2	89.7	99.1	89.6	100.5	84.4	1.9
	1992	87.0	85.8	86.1	101.0	57.0	66.6	9.4
	1993	87.1	85.2	85.7	95.0	83.0	83.0	15.1
	1994	75.0	72.0	71.5	83.0	67.0	...	19.8
	1995	91.1	...	92.1	72.9	63.0	...	2.8
Kyrgyzstan	1991	...	94.8	99.7	90.0	87.0	75.1	1.9
	1992	...	81.0	73.6	95.0	65.0	41.0	10.1
	1993	83.6	82.9	74.7	90.0	69.0	84.3	13.9
	1994	75.0	73.0	75.5	85.0	51.0	99.1	3.8
	1995	93.8	...	87.5	98.0	182.0	94.0	1.5
Tajikistan	1991	...	91.6	96.4	95.6	85.0	78.8	1.8
	1992	...	69.0	75.8	55.0	31.0	25.4	10.1
	1993	82.7	79.0	80.5	96.0	100.1	78.3	15.8
	1994	88.0	87.0	69.2	75.0	57.0	...	3.4
	1995	87.6	...	94.9	72.0	75.0	...	5.4
Turkmenistan	1991	...	95.3	104.8	95.8	111.0	84.6	1.9
	1992	...	...	85.1	91.0	120.0	63.8	9.3
	1993	...	110.0	104.0	116.0	145.0	94.5	18.7
	1994	...	...	75.0	102.0	...	...	28.1
	1995	...	...	93.1	90.0	...	...	...
Uzbekistan	1991	99.5	97.6	101.5	98.9	105.0	79.3	2.1
	1992	90.4	87.1	93.3	95.0	65.0	55.0	7.0
	1993	97.6	96.5	93.0	101.0	95.0	114.9	10.4
	1994	96.0	93.0	101.0	99.0	80.0	89.9	16.5
	1995	98.8	...	100.2	97.0	104.0	...	4.2

Sources: Interstate Statistical Committee of the Commonwealth of Independent States, *The CIS Member-Countries in 1992* (Moscow, 1993), pp. 26-29, 40, 45 and 46; *The CIS Member-Countries in 1993* (Moscow, 1994), pp. 7 and 8; *The Economies of the Commonwealth of Independent States in 1994* (Moscow, 1995), pp. 59 and 60; *The CIS Member-Countries in 1995* (Moscow, 1996), pp. 7 and 8.

GDP in the Russian Federation fell by 4 per cent and industrial production by 3 per cent. In all Central Asian countries the rupture of economic ties was accompanied by deep financial crisis, loss or fragmentation of traditional markets, introduction of barter arrangements, deindustrialization and paralyzed investment activity, splitting up of the infrastructure, sharp growth of unemployment and impoverishment of population and mass-emigration of Russian-speaking qualified labor. According to Russian economist B. Bolotin, during the period of 1990-1995, real GDP per capita decreased by almost three times in Kazakhstan, Uzbekistan and Tajikistan, by 2.5 times in Kyrgyzstan, and by 10 per cent in Turkmenistan (according to other estimates – by almost two times) (Zhukov and Reznikova 1994).

By mid-1993, it became obvious that disintegration had gone far enough and its cost was unbearable. Breaking away from centralized system brought all it could give (in terms of power and property). It was the time to start moving back if the CIS countries really wanted to protect their economic potential from complete destruction and to avoid being rolled decades or even centuries back into the past. The President of Kazakhstan N. Nazarbayev in one of his statements that year stressed the following point: "The CIS countries must follow the path of Western European states. We should coordinate our legislation, set up a common parliament and a permanent common government based on the CIS Consultative Coordinating Committee. We should speed up the establishment of customs, banking, payments and other unions which are envisaged by the Economic Union" (Nezavisimaya Gazeta 1994). Time has come to consider ways and appropriate means of reintegrating the CIS countries and reviving their almost destroyed but still viable common economic space.

III. EFFORTS TO REVITALIZE ECONOMIC RELATIONSHIP

As far as political declarations are concerned the need to preserve the common economic space has not been questioned by anyone in the CIS from the moment of the dissolution of the former USSR. However, the leaders of the CIS countries took a different view of this concept which was soon revealed in practice.

Ideally, common economic space (which is equivalent to a common market), in order to be effective, should have: 1) a common customs union with only one external and no internal tariffs; 2) a common two-tier banking system with a central bank at the top preferably set up following the model of the United State Federal Reserve System; 3) a single supranational currency issued by a single authority or several national currencies freely convertible at a mutual fixed rate; 4) common rules for the unimpeded movement of goods, labor, scientific and technical expertise and capital including the unlimited freedom of acquiring property within the territory of such a union; 5) a common infrastructure, including energy, transport and communication, jointly managed and financed; and joint, presumably small, budget for common needs preferably financed through a single tax.

Naturally, all this would require hard and continued efforts to coordinate economic policies and unify tax, banking and insurance laws, property rights, currency regulations, social security systems, etc. And there should be no illusions as to the inevitable renunciation (for common good) of a certain degree of economic sovereignty and transfer of some vital management and economic functions to supranational institutions (possibly with the right of veto for every national member (as is the case in the European Union), or without it (Shmeliev 1994).

The first attempt to sustain common economic space within the CIS was the Agreement on "The Principles of Customs Policy" concluded in March 1992 which proclaimed as its objective the establishment of a customs union. The Agreement was a total failure; in 1992 the CIS countries began to establish customs borders and introduce customs duties and non-tariff limits on mutual export-import transactions which by definition do not exist in a customs union. Considerations of immediate necessity prevailed over long-term and even short-term interests of the parties to the Agreement. The only positive outcome for

Central Asian countries was the declared intention to exempt from customs duties all goods supplied to them by the Russian Federation under intergovernmental agreements and to abolish VAT and excise tax on goods traded with that country.

Instead of embarking on a path leading to economic consolidation attempts were made in 1993 to restore economic relations on former, nonequivalent basis and to revive the role of the Russian Federation as a supplier of cheap energy resources and nonreturnable credits. By that time, the Russian Federation had toughened its position in defense of its economic interests: both cash and non-cash monetary circulation was limited when "a new rouble" was issued, controls over extension of credits became more rigid and prices for exported goods (especially energy sources) were quickly reaching the world level.

As a sort of response six former Soviet republics (the Russian Federation, Belarus, Armenia, Kazakhstan, Uzbekistan and Tajikistan) in September 1993 signed the agreement on practical measures to set up a "new type of rouble zone". The agreement proclaimed the intention to use the rouble as the only legal tender within this zone, to coordinate the guidelines of economic policy and unify customs, tax, banking and currency laws, ways of regulating monetary systems and free movement of capital and labor as well as goods and services. The participants were also supposed to coordinate their budget deficits and interest rates and to support the single rouble rate of exchange *vis-à-vis* hard currencies by using the common gold and currency reserve fund etc.

At a certain risk of underestimating the problem one may assert that this agreement was also doomed to failure as the Russian Federation was not prepared to supply other republics with free cash and demanded that such flows should take the form of government credits with the transfer of a portion of those states' gold reserves to the Central Bank of the Russian Federation as security. The only practical result of the agreement was a speedy issue of national currencies by its signatories. Participation in a common "rouble zone" would have amounted to a compromise: indefinite consolidation of the Russian Federation's donor functions in exchange for a sizable part of republics' economic sovereignty transferred to the Russian Federation. Its Central Bank would have become the regulatory authority of the common monetary system, or a supranational body, if a common central bank would have been set up, would assume that function. In any scenario the degree of integration of such a grouping would have come very close to that of a single state which is not in the immediate interests of either the Russian Federation or any other participants in the "rouble zone".

The Treaty on "Economic Union of the CIS Countries" ratified in April 1994 revealed in full measure the prospects for the consolidation of the common economic space. Many provisions of this Treaty show that its authors borrowed from the West-European theory and practice of integration. The economic union is established by closer integration and coordination of actions during four consecutive stages: 1) an interstate (multilateral) free trade association; 2) a customs union; 3) a common market of goods, services, capital and labor; 4) a currency (monetary) union. A payments union has to be established as an intermediate stage before the transfer to a single supranational currency.

Unfortunately, practical implementation of this Treaty proceeds at a very slow pace. Free trade association and its culminating point – customs unions are beginning to take shape only in certain areas; there are still numerous internal tariff barriers within the CIS, as well as quotas for major goods especially energy sources, raw materials and foodstuffs; most CIS member-countries dare not even dream of a single customs tariff or a common policy toward third countries. While free movement of goods and services between states has slightly increased, freedom of labor migration and movement of capital, i.e. freedom of acquiring property in partner-countries, is only partial; there still exist numerous and tricky administrative taboos. For instance, every case of investment in another country, establishing a joint venture or a transnational industrial-financial group is processed individually. A payments union, i.e. clearing of partially convertible national currencies, is being pursued on bilateral basis, and an interstate clearing bank has not begun its activities yet.

At present, there exists within the CIS a uniquely chaotic system of payments which are effected at freely floating exchange rates of "soft" national currencies mostly through commercial banks. They account for almost 75 per cent of all inter-republican payments. The rouble is more important for those payments than freely convertible currencies, and "rage for rouble" is now more acute in the CIS internal payment channels than US dollar.

Some experts even question the feasibility of a payments union. They see only two options: either a multilateral clearing system based on partially convertible or closed national currencies under which the prospects for normal, non-barter trade between countries would be severely limited by the amount of hard currency or a commonly acceptable currency (e.g. rouble) available in a pool to which participating countries can collectively contribute (with an additional problem of the possibility of bad debts being accumulated by one or several countries), or a switch to full convertibility of national currencies by all CIS countries

which effectively remove all barriers for cooperation by making mutual payments automatic. It has been noted that the only reason for establishing a payment union is the unwillingness of its participants to make their currencies convertible. But this means that they are satisfied with the status quo (Afanasjev 1995).

We believe, however, that this point of view is too extreme; one has to live in a real, not imaginary world. A common monetary system based on several fully convertible national currencies or a supranational currency means a higher degree of integration as compared to unification of markets for goods and services and must follow such unification but does not precede it. A common monetary system also involves a common taxation system and common budget, centralized decision-making as regards customs, taxation, emission, interest rate and monetary policies. The Maastricht agreements were based on almost 40 years of gradual progress along the way of European integration. Obviously, the CIS countries still have a long way to go to reach this level of integration. The immediate possible option for them would be an introduction of floating exchange rates similar to the well-known European "monetary snake".

The idea of a Euro-Asian Union put forward in 1994 by the President of Kazakhstan N. Nazarbayev provoked much interest in the CIS countries. Attractive as it is, this idea is rather a political, long-term goal, and the formation of such a union in the foreseeable future is unlikely. None of the CIS countries is actually ready today for such a high degree of integration while they still cherish hopes for a restoration of the old practice of subsidizing economic cooperation by the main donor country – the Russian Federation, and the principles of full equivalence in their mutual exchanges are not yet firmly established.

The signing of the Treaty on "Enhanced Integration in Economic and Humanitarian Areas between Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation" on 29 March 1996 and the Treaty on "The Formation of the Commonwealth of Sovereign Republics Consisting of the Russian Federation and Belarus" on 2 April 1996 were the most recent practical steps toward the restoration of common post-Soviet economic space. Both agreements are open for any other state that wishes to join them on voluntary and mutually beneficial basis and on an equal footing. The CIS countries seem to have embarked on a more practical course – integration by regions and subregions, sectors and areas where at present there is a strong mutual attraction ("local integration") while maintaining the long-term, common integration goals set out in the Treaty on "Economic Union".

IV. STRATEGIC INTERESTS FOR INTEGRATION

The Central Asia region is an exceptionally significant zone of political, economic and defense interests of the Russian Federation.

From the economic point of view its priority interests in the region are as follows: 1) ensuring the fulfillment of goods delivery commitments; 2) ensuring the repayment of goods delivery debts; 3) repayment of earlier extended credits; 4) nondiscrimination with regard to the transit of goods from the Russian Federation within the territory of these countries; 5) removing the factors that increase the spontaneous migration of Russian-speaking population from the countries of this region to the Russian Federation. Since bilateral agreements are most effective in achieving these goals, the multilateral approach to regulating the cooperation with the Central Asian region is not of primary importance to the Russian Federation.

Strategic economic interests of the Russian Federation are determined first and foremost by the fact that it would take many years and huge investments to create alternative production capacities that could compensate for the loss of traditional suppliers from the region. Besides, the Russian Federation is unwilling to lose this long-established market to competitors from third countries; it is there that manufacturing industry of that country striving to penetrate world markets has the best chance for success.

As a supplier to the Russian Federation the region of Central Asia has many indisputable advantages. Until recently all-union production of mercury concentrate, vanadium-aluminum alloy compositions, metallurgical barium, half of metallic vanadium, rhenium and antimony and other rare metals were localized there. The states of the region have virtual monopoly in the production of nonferrous metals (copper, zinc, lead, tungsten, molybdenum, mercury), and the supplies of these are still very important. Central Asia has vast gas, oil and coal reserves, and the Russian Federation could participate in their exploitation in order to use part of these resources to meet the needs of its Eastern areas and to save some of its own fuel resources for export. Besides, Tajikistan and Kyrgyzstan possess rich hydroelectric resources; their continued harnessing offers broad prospects for the increased power supplies to the Ural

and Siberia. According to Russian economist B. Plyshevsky, it is also important to maintain large specialized enterprises especially in machine-building, electronic and defense industries closely tied to corresponding enterprises in the Russian Federation (Plyshevsky 1994). Partners in these sectors will have to employ new technologies and develop the output of new products both for the market of the Russian Federation and for export to third countries. Finally, it is obvious that the Russian Federation is interested in long-term supplies of long-staple (and some short-staple) cotton, fruits, vegetables and grains from the Central Asian region.

The Russian Federation is interested in the development of transport, communication and other elements of infrastructure in Central Asia on a long-term basis. At present, the regional transportation network is being reconstructed and expanded to provide the access not only to the post-Soviet markets but also to the Near and Middle East and Asian-Pacific regions. The foreign trade of the Russian Federation will benefit from the expansion of existing and construction of new communications, and that country is ready to participate (and is already taking part) in their technical renovation, improvement and operation, especially in Kazakhstan and Turkmenistan. Of particular interest is the construction of the 10,000 km long Trans-Asian Railroad from Beijing to Istanbul which will run across Turkmenistan, Uzbekistan and Kazakhstan. The access to this railway link and involvement in its operation would allow for the transportation of exports from and imports to the Russian Federation and transit goods from third countries to Turkey, Iran, China and other Asian states. The Russian Federation is also interested in the long-term prospects for its involvement in the development and transportation of oil from the Caspian Sea oil-fields in Kazakhstan, in new patterns of inter-country distribution of Turkmenistan's gas and oil and in internationally agreed solution to the problems of recovery and transportation of oil on the Caspian Sea shelf.

The destiny of numerous Russian-speaking populations in Central Asia (about seven million people) is a separate issue of political and economic significance. The exodus of this population to the detriment of industrial, educational and scientific-technical potential of the countries in the region also puts a heavy burden on the Russian Federation where severe unemployment is likely to remain one of the most serious social issues. In the final analysis it is necessary to work out common measures to guarantee the equality of constitutional, social and economic rights of people of Russian origin with the rights of the local population; otherwise, a profound economic integration within the CIS is unlikely.

At the moment, Central Asian countries are primarily interested in using the integration mechanism to overcome their acute economic problems; preserving access to the energy resources in the Russian Federation on concessional terms and maintaining special status in terms of trade credits and payment of debts; slowing down the transition to world prices in mutual trade between the CIS countries (but not all of them: Turkmenistan, for example, receives 60 per cent of the world price for its gas, and even at this price level the debts of its consumers are constantly rising). Naturally, the Central Asian states (again, with the exception of Turkmenistan) would prefer to solve these problems on multilateral basis as it provides greater chance to secure the desired concessions.

Strategic, long-term interests of the Central Asian countries consist in restructuring their economies (or, rather, in adding new and promising industries to the existing ones); eliminating or at least reducing their dependence on the Russian Federation and increasing economic self-sufficiency and security; changing the geographic direction of foreign economic relations; and finding new donors of financial and technical assistance. Within the next few years three out of five countries in the region – Kazakhstan, Uzbekistan and Turkmenistan – will become completely self-sufficient in oil, gas, coal and products of their processing and refining and will be able to export, achieve self-sufficiency in foodstuffs, greatly increase ore mining and production of nonferrous metals, gold, uranium, rare-earth elements and other strategically significant raw materials. A marked change in the geographic direction of their foreign economic ties is quite likely in the future: Kazakhstan, Uzbekistan and partially Kyrgyzstan – to the European Union and the Asia-Pacific region, Turkmenistan – mostly to the Middle East and Europe. It is impossible to make any definite conclusions about Tajikistan, but this is a “special case”.

Thus, there is an obvious disagreement between current as well as long-term strategic interests of the Russian Federation and the Central Asian states. The Russian Federation is interested in equivalent exchange, the latter countries – in nonequivalent (naturally, to their advantage); the Russian Federation stands for a most favoured nation (MFN) trade regime, the countries of the region wish to preserve a highly concessional, preferential treatment; the Russian Federation (at least at this stage) wants to develop bilateral ties, the Central Asian states prefer multilateral systems; the Russian Federation is in favour of maintaining the existing interstate specialization, while countries of this region would like to change it.

This disagreement is reflected in the concept of “uneven integration” which seems quite natural and logical: in certain areas some

countries are ready for more advanced forms of integration while others are not ready yet. In future, moving in both directions at the same time will probably become inevitable with the choice between bilateral and multilateral forms of cooperation being determined by purely pragmatic considerations of partners. However, there is one very important thing that everyone should understand: it is neither feasible nor reasonable to preserve the old pattern of interdependence between partner-countries that was determined primarily by the defense needs of the former Soviet Union.

According to one analyst (Kirichenko 1995), the following objectives can knit together the CIS as an integration grouping of countries concerned and ensure its long-term effectiveness to the benefit of all participants:

- Finding the place of the CIS economic union in the world economy and in the relations with other groupings and collective protection against discrimination, unfair competition, legal and economic sanctions and other threats from third countries and interstate unions
- Coordinated restructuring of inter-republican specialization and production patterns
- Making breakthroughs in the technological base for the production of goods and services, increasing common scientific, technical and educational potential and joint implementation of complex research and development programmes
- Design and implementation of large-scale environmental projects

Centres of economic power in the world are based on the leadership in science, technology and education. It corresponds to the long-term interests of the Russian Federation. It also corresponds to vital interests of the Central Asian States. It has been observed in a recent publication (International Union of Economists and the Free Economic Society of Russia 1995) that it is difficult to imagine receiving European or world class education in the Central Asian States in English or in a native tongue – it is just not possible. Gaining knowledge and education, achieving a modern level in engineering, technical, chemical, biological, agricultural and other higher educational establishments without the Russian language and without the support of major educational Centers of the Russian Federation is a hopeless undertaking that run against the national interests of the Central Asian countries.

In its economic policy toward the CIS countries the Russian Federation proceeds from the principles of voluntary cooperation using both bilateral and multilateral agreements, equivalence of exchanges and the balance of interests of different parties while protecting its own economic interests and giving up the role of a financial donor often imposed on it, efficiency of proposed projects, flexible and selective approaches depending on partners' willingness to cooperate and specific and well-grounded nature of its assistance to newly-independent states in pushing forward market-oriented economic reforms. However, it has become evident that the restoration of common economic space of the CIS countries and their further integration cannot be achieved by government decrees alone, no matter how wise they might be.

Many Russian economists warn against too much "coordinating activities", against attempts to achieve "top-bottom" integration as soon as possible and through old methods of the former Council for Mutual Economic Assistance (CMEA), i.e. by "establishing a giant political pseudo-integration superstructure in the form of numerous inter-governmental and interstate bodies, committees, commissions and agreements above the primitive system of interstate barter trade" (Institute of World Economic and Political Research 1995: 19). The danger of such developments obviously exists: there is a strong inclination toward the growth of "integration bureaucracy," while the CIS countries have not yet started the implementation of practical tasks, e.g. those relating to the mutual payments system at the micro-level (i.e. at the level of agents of the market economy) throughout the multi-currency space of the CIS.

At the same time integration at the micro-level, development of horizontal ties, establishment of joint enterprises and transnational industrial, commercial and financial structures – all these contribute to the process of restoration of common economic space within the CIS. It is only through the initiatives of producers, traders and financial experts that one can save, for instance, a deeply-integrated network of long-established, well-equipped military production facilities which stand idle both in the Russian Federation and in Central Asia, and to ensure their conversion to the production of civilian goods. That is the only way to restore traditional markets and face cutthroat competition from third countries. The Presidents of the CIS countries should stop arguing about who owes whom and when the payments are due: capabilities for the conversion of debts into property should be envisaged and the facility providing for free flows of direct and portfolio investments throughout the CIS territory must be established.

A group of Russian researchers believe that within the CIS "only transnational groups of entrepreneurs are capable of putting an end to the disintegration of economic ties and reversing the process toward reintegration. That would help to use the potential of cooperative enterprises, to accelerate the accumulation of resources for investment and ensure their effective use, to take informed decisions concerning structural adjustment of the economy... Some of them are well on the way to becoming full-fledged transnational companies with a unified structure of management, including banks, insurance companies, servicing, marketing and consulting units. Among the pioneers in this field are the joint-stock companies dealing with oil such as "LUKoil", "UKOS" and "Surgutneftegaz", the "Gazprom" concern, "VAZ", "KAMAZ" and other production associations" (Economic Branch of the Russian Academy of Sciences and the International Foundation for Reform 1994: 33-34). According to their estimates, 450-500 various transnational associations with participation of the Russian Federation may well spring up within the CIS territory in the years to come. And this, by any measure, would surely constitute a solid basis for the integration of the whole post-Soviet economic space.

V. CONCLUDING OBSERVATIONS

Meaningful integration means a wide network of stable micro-economic entities. It is still too early to speak about the economic integration within the CIS as its practical implementation is lagging behind. Besides, the development of such integration requires a certain measure of political will: renunciation of narrow-minded nationalism, on the one hand, and elimination of relapses into the former Soviet-era mentality, on the other. Such integration would also be impossible without a substantial financial burden being borne by the strongest partner – the Russian Federation. However, age-old political, economic and cultural ties between the peoples living in the post-Soviet space create a powerful incentive to bring them closer on a new basis.

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