

ENTREPRENEURSHIP DEVELOPMENT FOUNDATION

The Project:
OIL REVENUES: CHALLENGES FOR AZERBAIJAN
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Oil Revenues and Institutional Reforms



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Another round table discussion on the project was held on July 12 2007. The subject of the round table was the following: **“Oil revenues and institutional reforms”**. Dr. Inqilab Ahmedov, the president of the Public Finance Monitoring Center and Dr. Christos Kostopolous, Senior Economist for Azerbaijan, WB, made reports at the round table.

The round table was attended by: Inqilab Ahmedov (Public Finance Monitoring Center), Christos Kostopolous (Senior Economist for Azerbaijan, WB), Azer Amiraslanov (member of parliament), Vahid Ahmedov (member of parliament), Ali Masimli (member of parliament), Nasib Nasibli (member of parliament), Zaur Veliyev (Ministry of Economic Development), Tural Mahmudov (National Bank), Ceyhun Huseynov (National Bank), Elchin Gulaliyev (National Bank), Jon Romberg (Ambassador of Norway), Elmira Mirzayeva (Norway Embassy), Basil Zavoico (International Monetary Fund), Raqib Quliyev (Technical University, professor), Ali Alirzayev (Economic University, professor), Rasim Musabayov (political scientist), Konul Chalilova (State Oil Fund), Saida Bagirova (World Bank), Sevgim Rahmanov (Union of Sellers and Producers), Mirvari Gahramanli (OWC SSO), Ruhangiz Huseynova (QAH SSO), Askər Ahmed (DDMF), Aybeniz Ganjaliyeva (USAID), Servet Maharramov (USAID), Hagigat Mammadli (QHH SSO), Mehriban Vezir (AQASIM SSO), Rovshan Karimov (“Novosti-Azerbaijan” Information Agency), Lala Allahverdiyeva (First news), Vasif Cafarov (“Ekpress” newspaper), Zohrab Ismayilov (Centre to Assist the Free Economy), Adil Abdullayev (SME Association), Elchin Eldaniz (“Ayna” newspaper), Rovshn Agayev (ITY SSO), Azer Mehtiyev (ITY SSO), Gubad Ibadoglu (Economic Research Center), Osman Gunduz (Azerbaijan Internet Forum), Faqan Aliyev (Academy of Ecoenergy), Namik Azizov (Union of Azerbaijan Managers), Anar Ahmedov (CRRC), Suheylyla Jafarova (Eurasia Foundation), Nariman Agayev (EITI Coalition), Aydin Nizamov (EITI Coalition), Vusal Gasimli (Economic Research Center), Sabit Bagirov (Entrepreneurship Development Foundation), Alovzat Bayramov (Entrepreneurship Development Foundation), Irada Eyvazova (Center for Economic and Political Research)



Oil revenues and the budget process: Calls for institutional reform

*Dr. Inqilab Ahmadov,
Public Finance Monitoring Center*

Oil and gas producing countries have a number of budget peculiarities. These are the following.

1. The share of oil revenues in budget incomings is usually high or too high (25-90 per cent);
2. The pace of growth in the budget sharply changes due to the situation in most cases;
3. Budget-related risks are too high here;
4. The legislative base that regulates the budget system is not perfect for a number of reasons;
5. There are problems in the effectiveness and transparency of the budget;
6. The influx of high revenues into the country's economy causes a syndrome of "wastefulness" in the government.

Now let us have a look at the near future of Azerbaijan's macroeconomic panorama at the present stage. To this end, the calculations of experts of the Center for Monitoring of Public Funds on the basis of figures recently announced by the IMF seem interesting. The actual and forecast macroeconomic indicators of the Azerbaijan Republic calculated by the International Monetary Fund:

	Years						
	2006	2007	2008	2009	2010	2011	2012
GDP (in billions of dollars)	19.81	27.225	36.26	42.1	45.72	48.1	51.5
Revenues of the review budget (in billions of dollars)	5.4141	9.066	20.27	25.05	26.56	26.45	26.21
Spending of the review budget (in billions of dollars)	5.1931	8.44	11.42	14.86	18.56	23.23	28.99
Oil Fund asserts ² (in billions of dollars)	1.9361	3.093	13.659	26.120	36.387	40.918	36.967
Correlation to GDP (per cent)	9.81	11.4	37.7	62.04	79.6	85.07	71.8
Oil revenues ³ (in billions of dollars)	2.97	5.36	15.55	19.37	19.80	18.47	16.79
Correlation to GDP (per cent)	41.1	24.4	20.9	22.6	25.8	30.5	35.5

Actual indicators

²Including the budget funds placed under the management of the Oil Fund.

³Oil revenues include the state share from HPBS and the taxes paid by foreign oil companies and the national oil company (SOCAR)

Source: Trend news agency

http://www.azstat.org/publications/azfigures/2007/az/020.shtml#t20_1

<http://www.imf.org/external/pubs/ft/scr/2007/cr07191.pdf>

On the other hand, if we look at the scenario offered by the IMF, we will see that the IMF advises the government to be more careful in using oil revenues. According to the scenario offered by the International Monetary Fund:

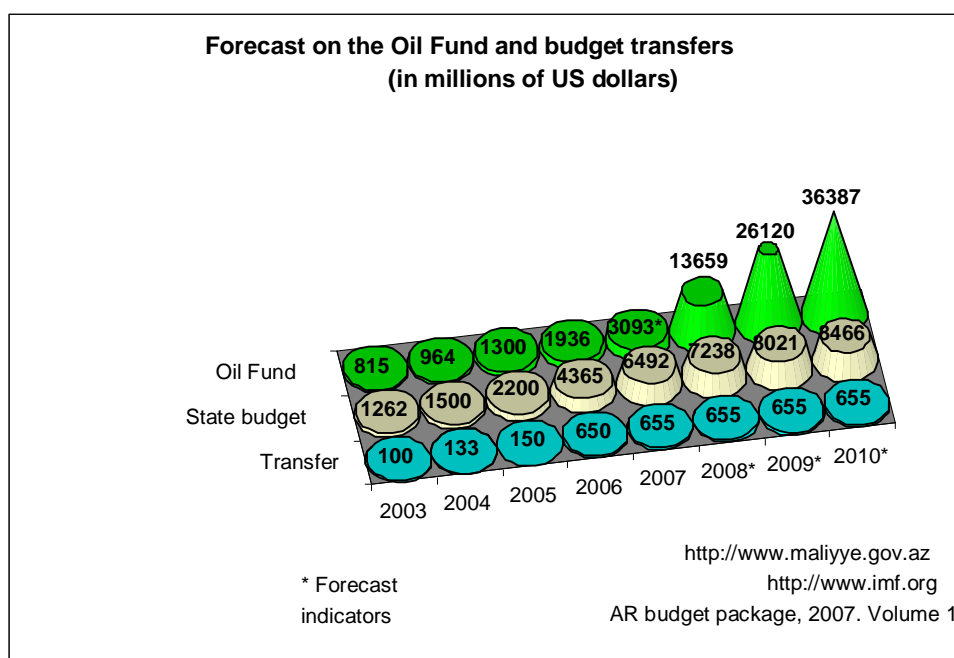
	Years						
	2006	2007	2008	2009	2010	2011	2012
GDP (in billions of dollars)	19.81	27.225	35.83	40.77	43.34	44.64	46.60
Revenues of the review budget (in billions of dollars)	5.4141	9.066	19.706	24.095	26.09	26.74	27.31
Spending of the review budget (in billions of dollars)	5.1931	8.440	9.71	10.48	11.18	12.00	12.72
Oil Fund asserts ² (in billions of dollars)	1.9361	3.093	14.715	31.072	48.726	65.781	81.916
Correlation to GDP (per cent)	9.8	11.36	41.07	76.21	112.4	147.36	175.78
Oil revenues ³ (in billions of dollars)	2.97	5.36	15.08	18.59	19.72	19.64	19.29
Correlation to GDP (per cent)	27.7	24.4	20.5	21.2	23.7	27.6	31.7

Actual indicators

²Including the budget funds placed under the management of the Oil Fund.

³Oil revenues include the state share from HPBS and the taxes paid by foreign oil companies and the national oil company (SOCAR)

Another interesting diagram is related to the sum of transfers between the Oil Fund and the state budget.



Thus, in general all these figures show that oil revenues are expected to skyrocket in the near future and the role of the oil factor will increase in the budget process. For the

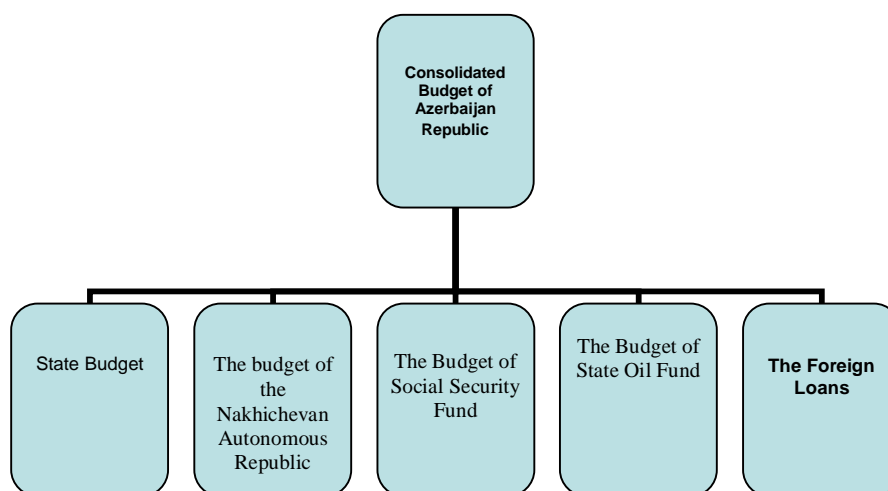
aforesaid reasons, as well as for a number of other reasons, there are numerous budget risks in Azerbaijan. These are the following:

1. *External risks* – changing oil prices cause fluctuations in budget revenues and changes;
2. *Operational/organizational risks* – imbalance between organizations; delays;
3. *Financial risks* – The likelihood of spending being artificially exaggerated and failure to fulfill revenue and spending forecasts in full;
4. *Fiduciary risks* – the tendency of budget revenues being sidelined from general economic development goals.

Against the background of these risks, there has also been a budget surplus problem in Azerbaijan, which stems from the implementation of the budget with a surplus in a favorable situation. But we have to keep in mind that a budget surplus does not create motivation for economic activity. Along with this, a budget surplus weakens the tax system. We have to point out that in our case, a surplus appears mainly because spending is not implemented in full. Since this problem is topical, amendments were made even to the law “On the budget system” recently. The following amendment was made to the law during budget discussions at the end of the last year: “The remains of all treasury accounts are transferred into a single treasury account at the end of the year (except for special purpose financing). One 12th of these funds is channeled into covering relevant budget expenses of the next year and into financing the state budget deficit, and is managed on the basis of the procedure indicated in the second paragraph of Article 19.2 of the law, which the remaining part of it is transferred into the State Oil Fund of the Azerbaijan Republic.” In this regard, despite the implementation of 2006, SOFAR executive director Shahmar Movsumov said the following: “According to the law “On the state budget of 2006”, if a surplus is discovered, the general budget of this year is divided into 12 and the sum that we get is deducted from the surplus. Only the remaining part is transferred to SOFAR. The budget of 2007 is expected to be 6.5 billion manats. If you divide this figure into 12, you will get 300-400 million manats. Last year’s surplus was even lower and totaled 74 million manats). For this reason, no money will be transferred to the Oil Fund in this regard.” There are also budget management problems in Azerbaijan, which stem from weak relations between the

review budget, the state budget, as well as the state budget and non-budgetary funds, and in general, from the weakness of “good management”.

The structure of the state budget of Azerbaijan



The revenue structure of the 2006 review budget

Indicator		Actual indicators	Special share (per cent)
Consolidated budget revenues	million AZN	4.256,6	100
including:			
State budget	million AZN	3.408,3	66.3
Revenues of the budget of the Nakhichevan Autonomous Republic	million AZN	103.9	0.3
Social Security Fund	million AZN	567.6	6.5
Revenues of the State Oil Fund	million AZN	807.8	19
Indirect state subsidies for the energy sector	million AZN	335.4	7.9
Total:	million AZN	5.223,1	
Note: When the revenues and spending of the consolidated budget are calculated, the following sums should be deducted from general revenues and expenses:			
Oil Fund transfers into the state budget	million AZN	585.0	
State budget transfers into the State Social Insurance Fund	million AZN	167.0	
Transfers from organizations financed by the state budget into the State Social Insurance Fund	million AZN	124.65	
Transfers to the Nakhichevan Autonomous Republic	million AZN	89.85	

Source: The 2006 state budget package of the Azerbaijan Republic. Part 3. Baku – 2005.

In the modern history of Azerbaijan, relations between the Oil Fund and the state budget have changed in the following way:

- Stage 1: There were no relations (2000-2002);
- Stage 2: The practice of transfers from the Oil Fund into the state budget. One-way relation (2003-2005);
- Stage 3: Mutual relations. Transfers from the budget into the fund (surplus or budget funds placed under management) (beginning from 2006).

Taking all this into account, the following proposals are important for improving the budget system.

- Improvement of the legislative base:
 1. It is necessary to draw up the law “On the budget system” again (terminological base (‘free residue’ phrase));
 2. The law “On the Audit Chamber” should be drawn up again;
 3. The law “On state financial oversight” should be drawn up again.
- Proposals regarding the management of the budget system:
 - The role and functions of relevant ministries (the Ministry of Economic Development, the Finance Ministry and the Tax Ministry), as well as the Cabinet of Ministers and the presidential administration should be reflected in a relevant statute;
 - It is necessary to speed up the switch of the corporate management of state institutions to international standards;
 - It is necessary to expand the powers of the Audit Chamber and strengthen general work;
 - It is necessary to apply the Medium Term Expenditure Framework;
 - It is necessary to draw up budget classification again;
 - It is necessary to solve the problem of quality staff selection for the process of managing public funds, and to separate administrative and political functions;

- It is necessary to initiate the process of applying budget participation and public hearings, and to gradually eliminate the imbalance between the budget;
- It is necessary to unify the basis of forecasts between the State Statistics Committee, the Finance Ministry, the National Bank and the Ministry of Economic Development;
- It is necessary to create a Council of Economic Security under the head of state.

* * *



World Bank Researchers Release Worldwide Governance Indicators 1996-2006¹

WASHINGTON, July 10, 2007 — The report, *Governance Matters, 2007: Worldwide Governance Indicators 1996-2006* being launched today by the World Bank Institute and the World Bank Development Economics Vice-presidency, shows that a number of countries - including in Africa - are making progress in improving governance and fighting corruption. This is encouraging given that good governance and corruption control are fundamental for long-term growth and reducing poverty.

“The hopeful news is that a considerable number of countries, including in Africa, are showing that it is possible to make significant governance progress in a relatively short period of time. Such improvements in governance are critical for aid effectiveness and for sustained long-run growth.” says Daniel Kaufmann, co-author of the report and Director of Global Programs at the World Bank Institute *“Bribery around the world is estimated at about US \$1 trillion dollars, and the burden of corruption falls disproportionately on the bottom billion people living in extreme poverty,”*

The report, authored by the World Bank’s Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, builds on research on the importance of governance and its impact on development over the past decade. Good governance matters for other human development outcomes such as infant mortality, illiteracy, and inequality, as well. Good governance has also been found to significantly enhance the effectiveness of development assistance in general, and of World Bank funded projects in particular.

Measuring countries' governance performance, and their improvements over time, is thus a key item on the governance agenda. But it is also a complex challenge, as

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<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21404282~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>

governance has many dimensions, each with inherent measurement challenges. The Worldwide Governance Indicators (WGI) project shows how this challenge can be met.

“The Governance Indicators put to rest the tired assertion that these issues cannot be robustly measured and the lessons drawn cannot be put to subsequent positive use by governments, the development community, civil society and the media,” says **John Githongo**, former Permanent Secretary for Governance & Ethics in Kenya’s Office of the President.

This year’s report represents a decade-long effort by the researchers to build and update the most comprehensive cross-country set of governance indicators currently available to the public. The aggregate indicators as well as data from the underlying sources are available at a newly-redesigned website at www.govindicators.org. The indicators cover 212 countries and territories, drawing on 33 different data sources to capture the views of tens of thousands of survey respondents worldwide, as well as thousands of experts in the private, NGO, and public sectors.

“Until the mid-nineties, I did not think that governance could be measured. The Worldwide Governance Indicators have shown me otherwise” says **Shlomo Yitzhaki**, Director of Israel’s Central Bureau of Statistics and Professor of Economics at the Hebrew University. *“It constitutes the state of the art on how to build periodic governance indicators which can be a crucial tool for policy analysts and decision-makers benchmarking their countries. Uniquely, it publicly discloses the aggregated and disaggregated data, as well as the estimated margins of error for each country. It definitely sets a standard for transparency in data.”*

The report shows that:

Some African countries are making significant strides on the path to good governance. Over the period from 1998 to 2006, Kenya, Niger, Sierra Leone have shown marked recent improvements in Voice and Accountability, while Algeria and Liberia have strengthened their Rule of Law. Countries like Algeria, Angola Libya, Rwanda and Sierra Leone have made improvements in Political Stability and Tanzania has recorded gains on Control of Corruption. The report also shows however that other African countries still face enormous governance and development challenges.

Emerging economies are matching rich countries on key dimensions of governance. Over a dozen developing countries such as Slovenia, Chile, Botswana, Estonia, Uruguay, Czech Republic, Latvia, Lithuania, and Costa Rica score higher on key dimensions of governance than industrialized countries such as Greece or Italy.

Improving governance helps fight poverty and improves standards of living. 10 years of research show that improved standards of living are largely the result of improved governance, and not the other way around. When governance is improved by one standard deviation, infant mortality declines by two-thirds and incomes rise about three-fold in the long run. Such an improvement is within reach as it is just a fraction of the difference between the worst and best performers. For example, in the dimension of Rule of Law, one standard deviation is all that separates the extremely low rating of Somalia from Cote D'Ivoire, or Cote D'Ivoire from El Salvador, or El Salvador from Italy or Botswana, and Botswana from the United Kingdom.

Where there is commitment to reform, improvements in governance can take place relatively quickly. While not the norm, a number of countries have made significant progress even in the very brief five-year period since 2002, as for example in Ukraine, Kenya, and Liberia in Voice and Accountability; and Angola and Algeria in Political Stability.

On average the quality of governance around the world has not improved much over the past decade, despite individual country improvements. For the countries that have done well, there have been a similar number that have experienced deteriorations in a number of governance dimensions, including Zimbabwe, Cote D'Ivoire, Belarus and Venezuela. And in many other countries no significant change in either direction is yet apparent.

Background Information

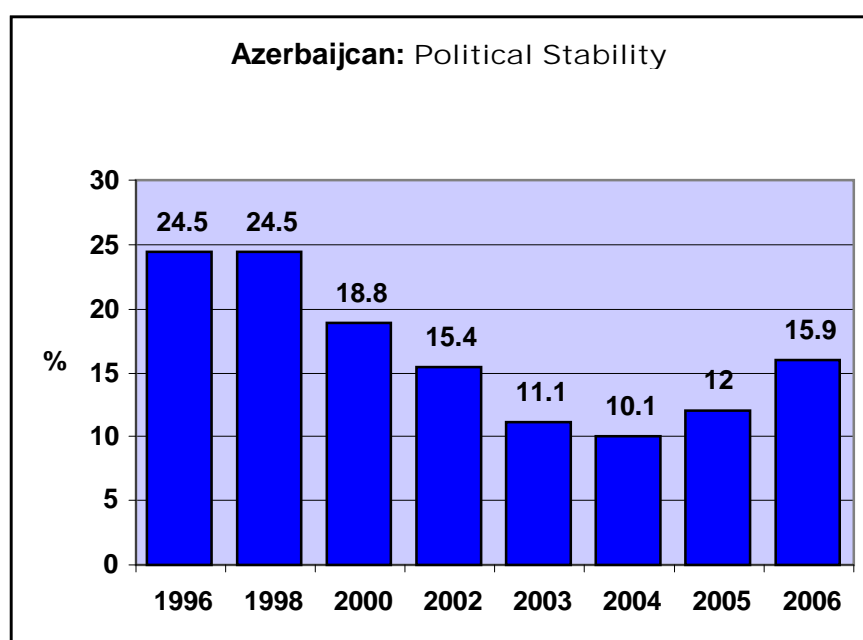
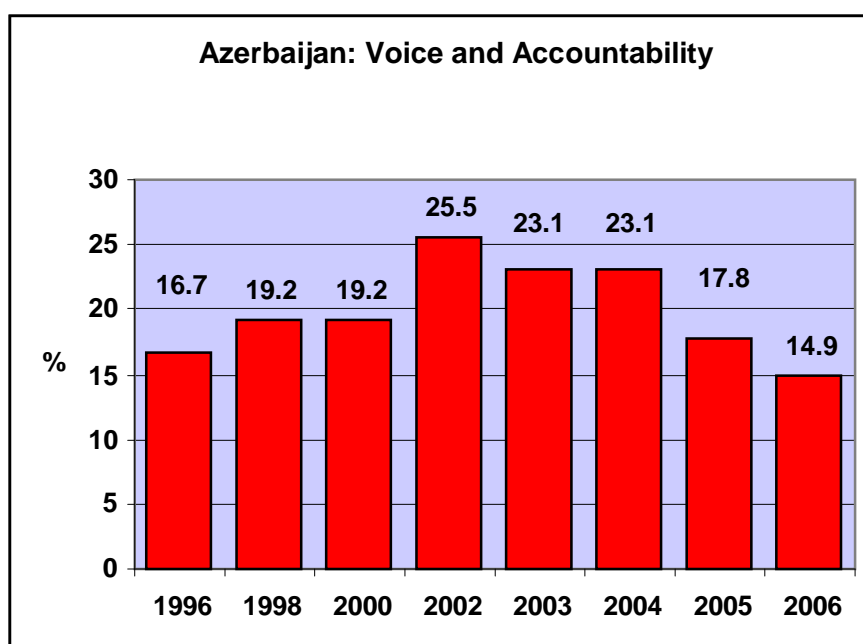
This is the sixth update of the Worldwide Governance Indicators, reflecting work over the past decade to develop evidence-based measures that help development stakeholders track the quality of institutions, support capacity building, improve governance, and address corruption.

The WGI measure the following six components of good governance:

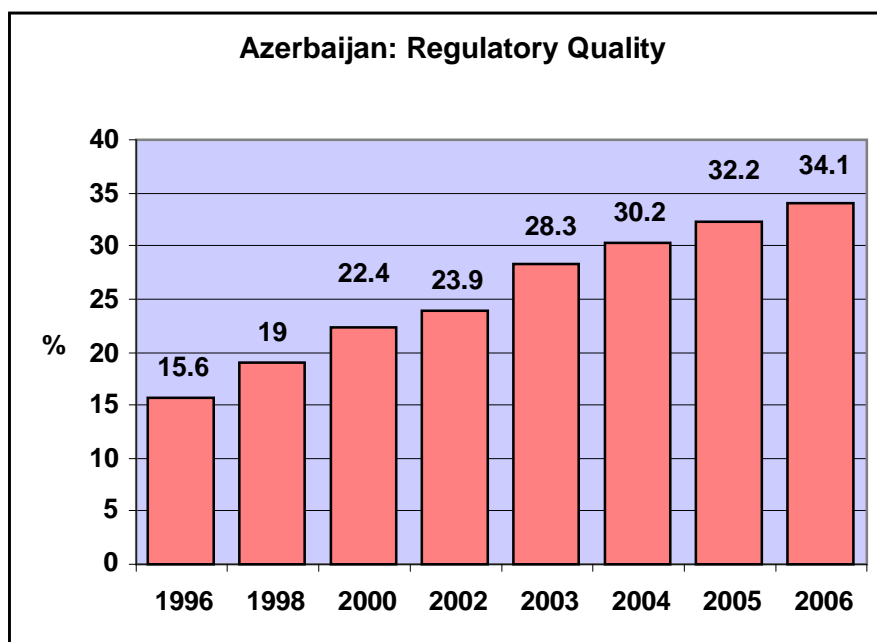
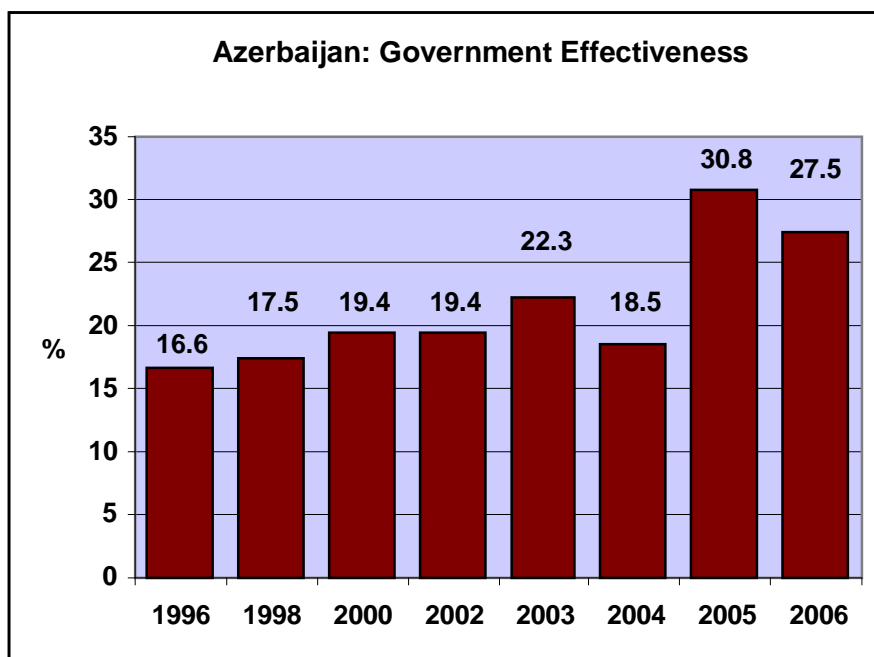
1. ***Voice and Accountability*** – measuring the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
2. ***Political Stability and Absence of Violence*** – measuring perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including terrorism
3. ***Government Effectiveness*** – measuring the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies
4. ***Regulatory Quality*** – measuring the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development
5. ***Rule of Law*** – measuring the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence
6. ***Control of Corruption*** – measuring the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests

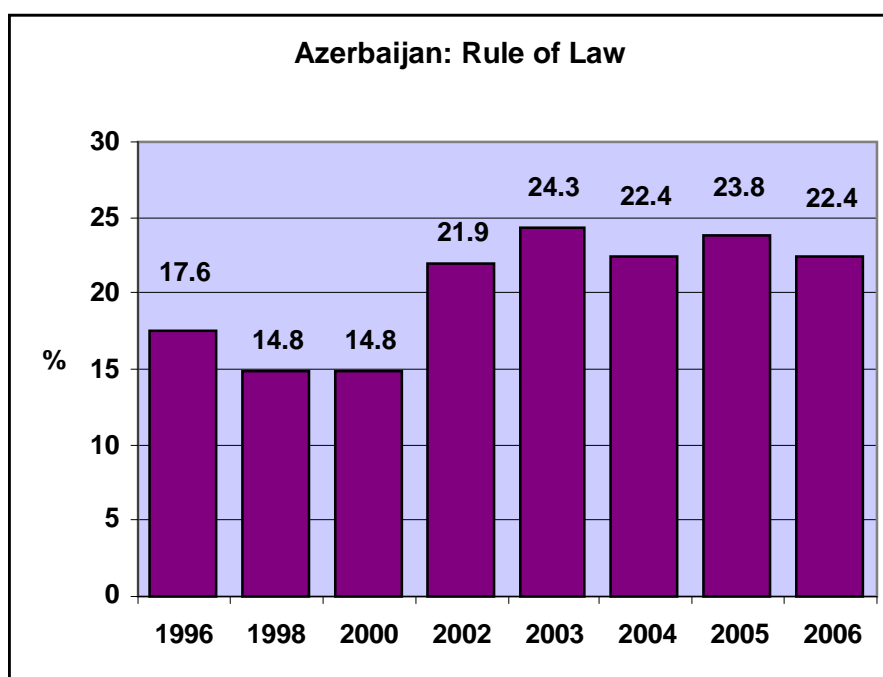
"Measuring governance poses unique challenges. Governance is complex and has many different aspects, and so no single indicator can fully capture a country's governance performance" says **Aart Kraay**, Lead Economist in the World Bank's Development Research Group, and co-author of the report. "It is therefore important to draw on the wide variety of data sources on governance currently available. The Worldwide Governance Indicators are a way of collecting and summarizing this wealth of information, based on the experiences and insights of stakeholders worldwide.

Governance Indicators 1996-2006: Azerbaijan²

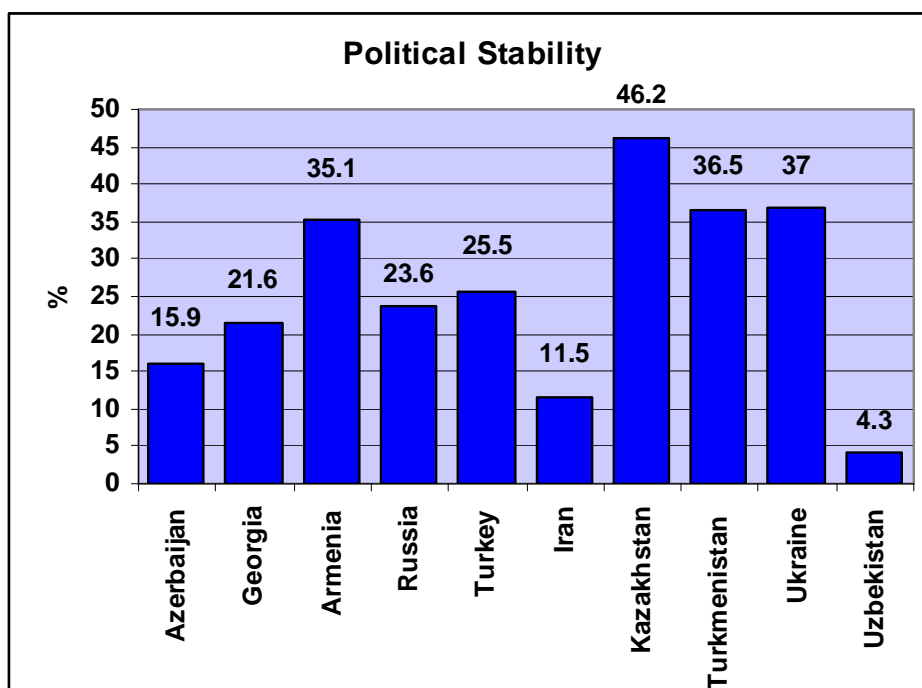
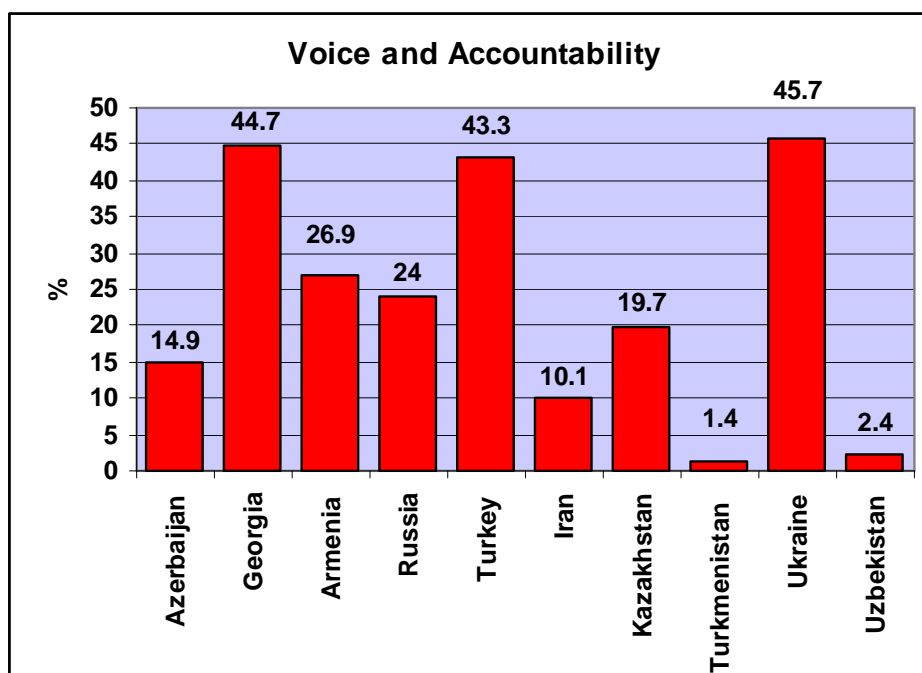


² http://info.worldbank.org/governance/wgi2007/sc_chart.asp

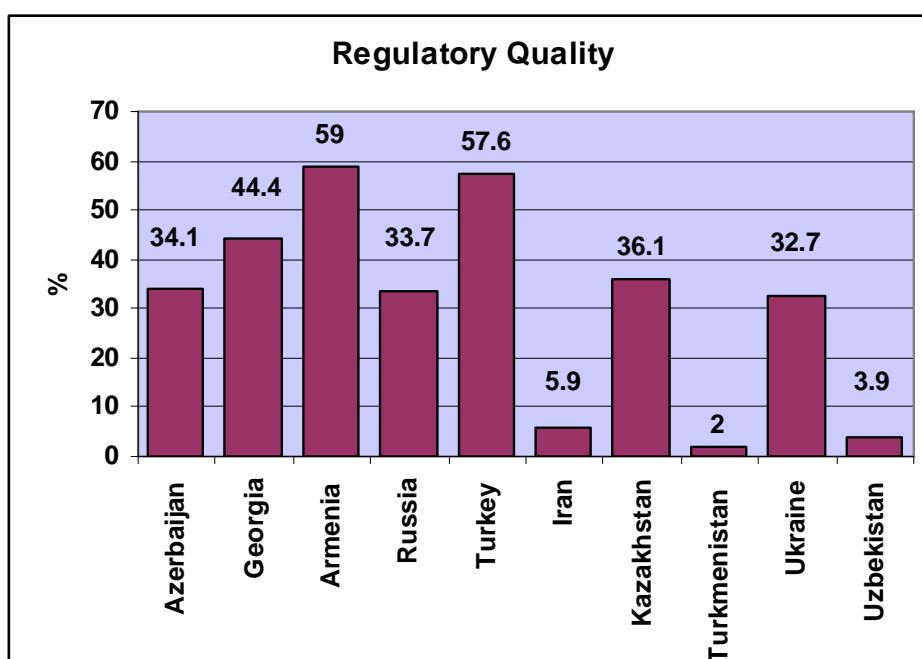
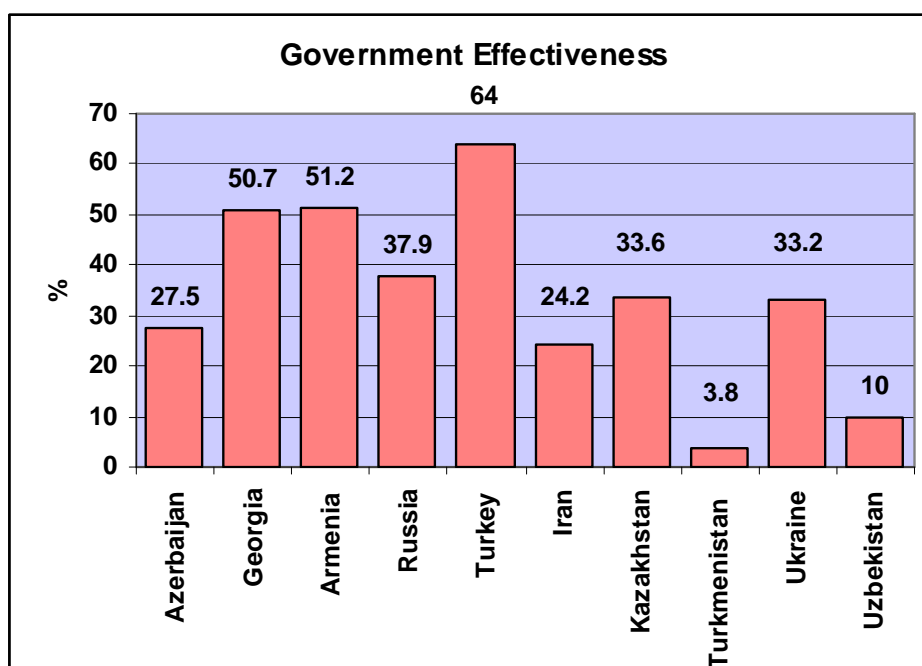


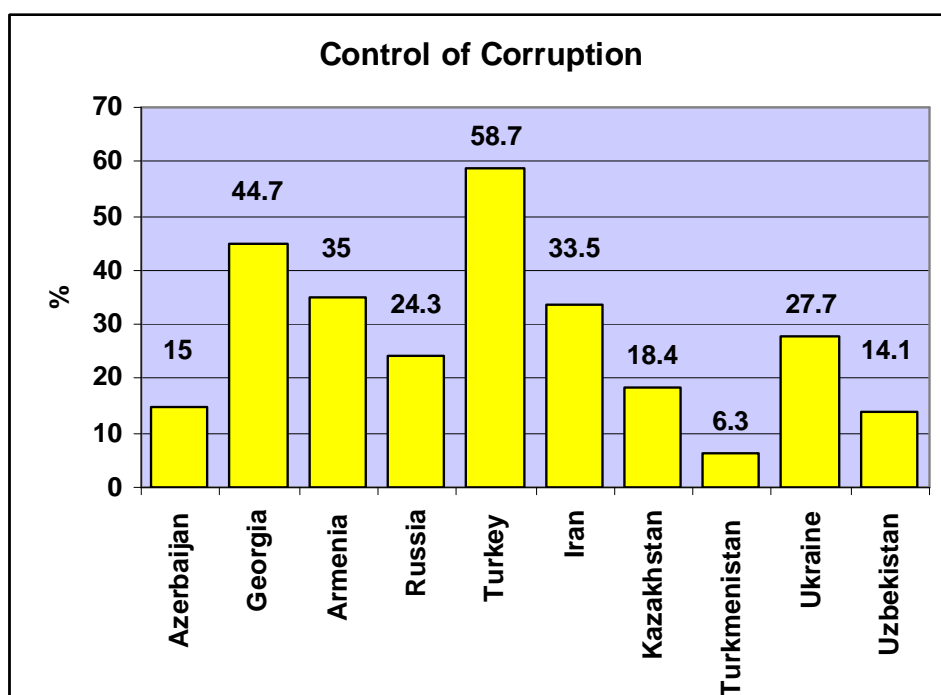
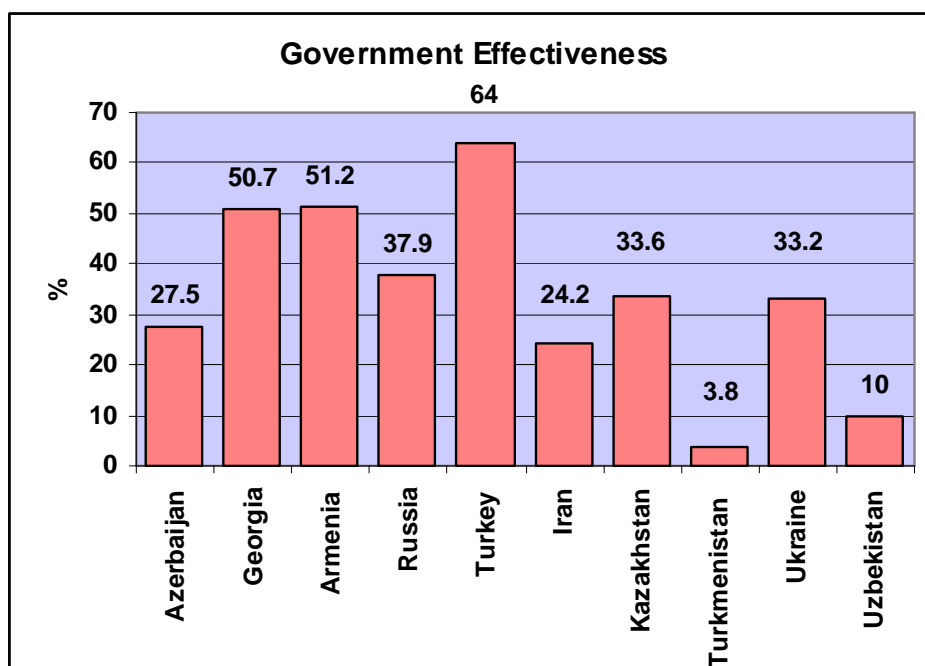


Governance Indicators 1996-2006: Azerbaijan and region countries³

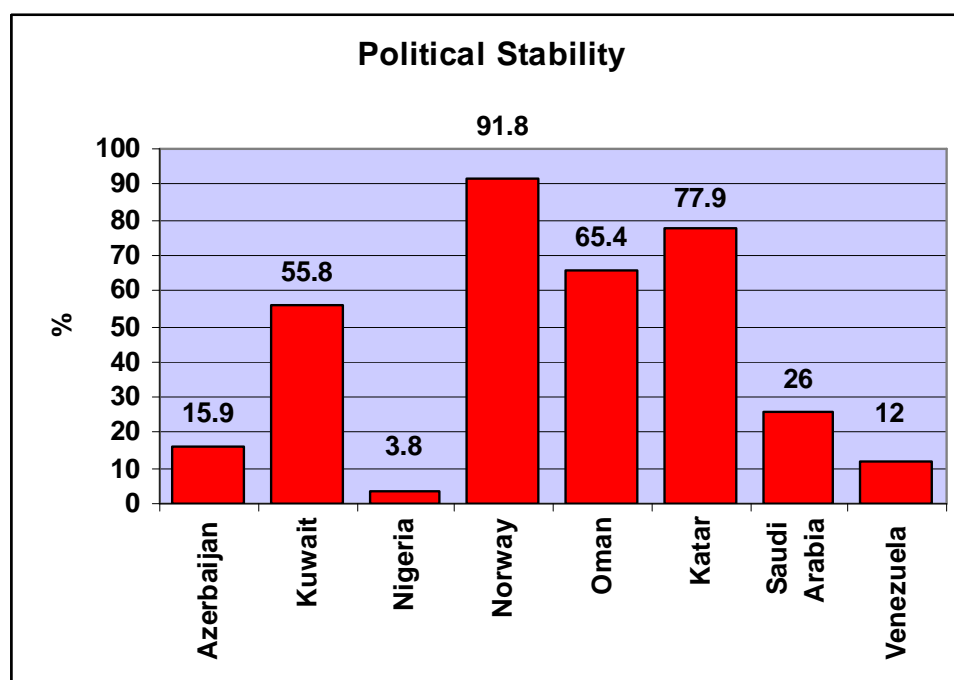
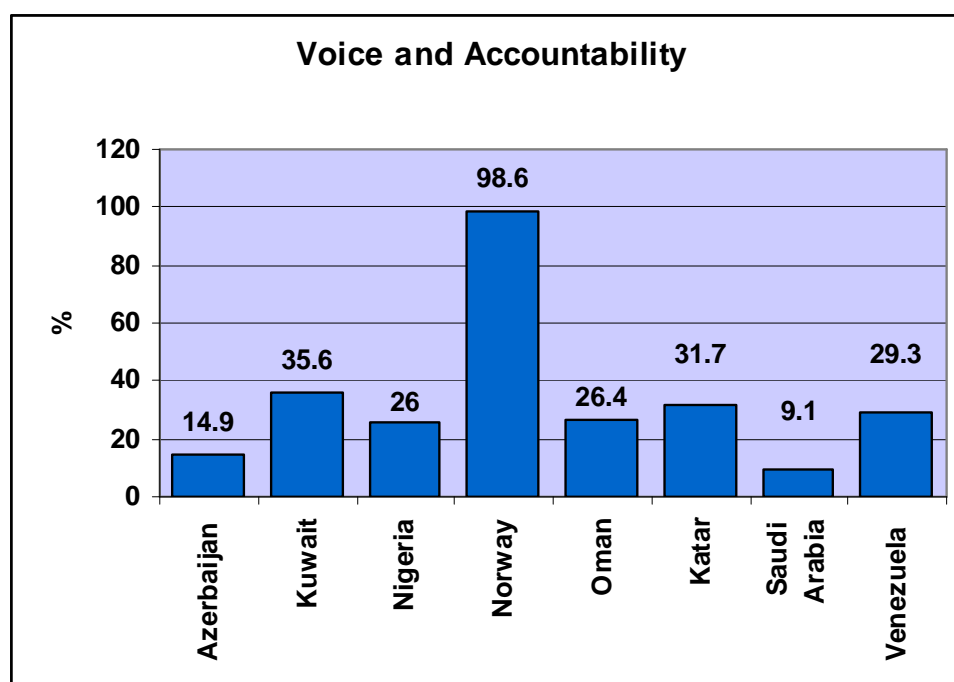


³ http://info.worldbank.org/governance/wgi2007/sc_country.asp

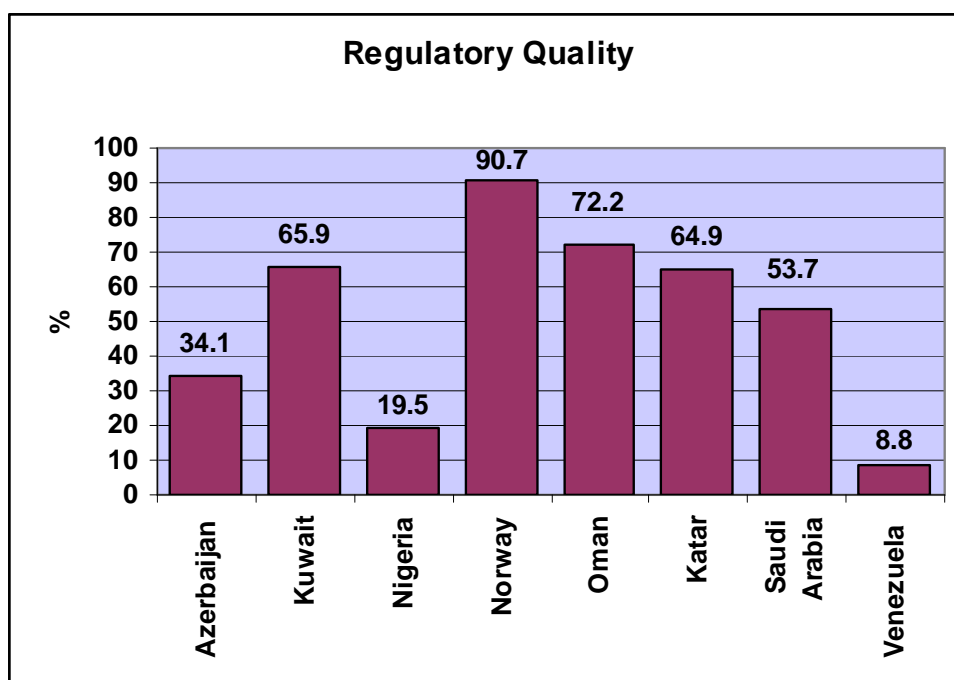
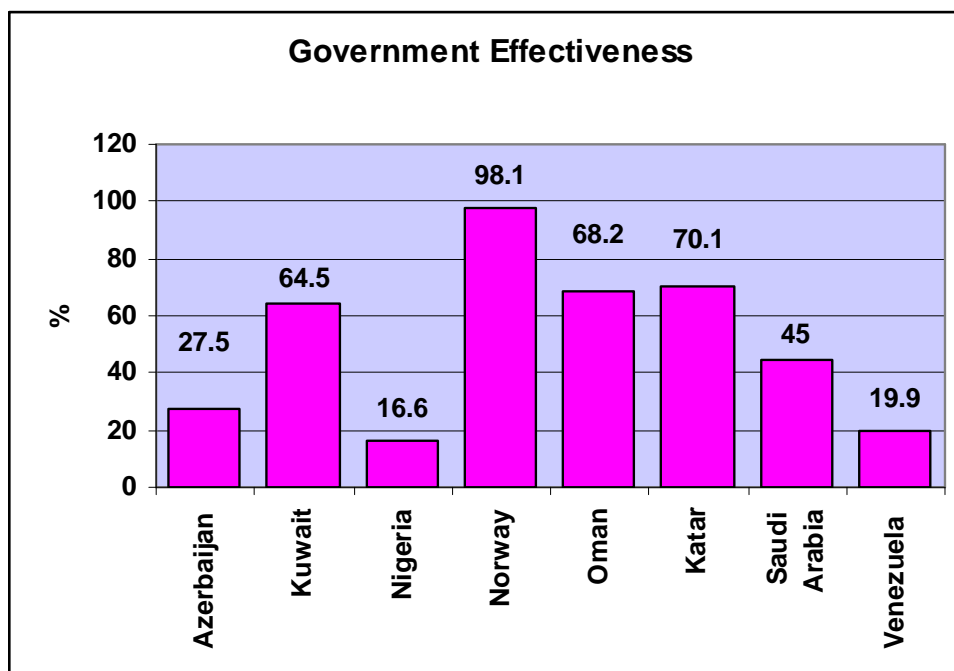


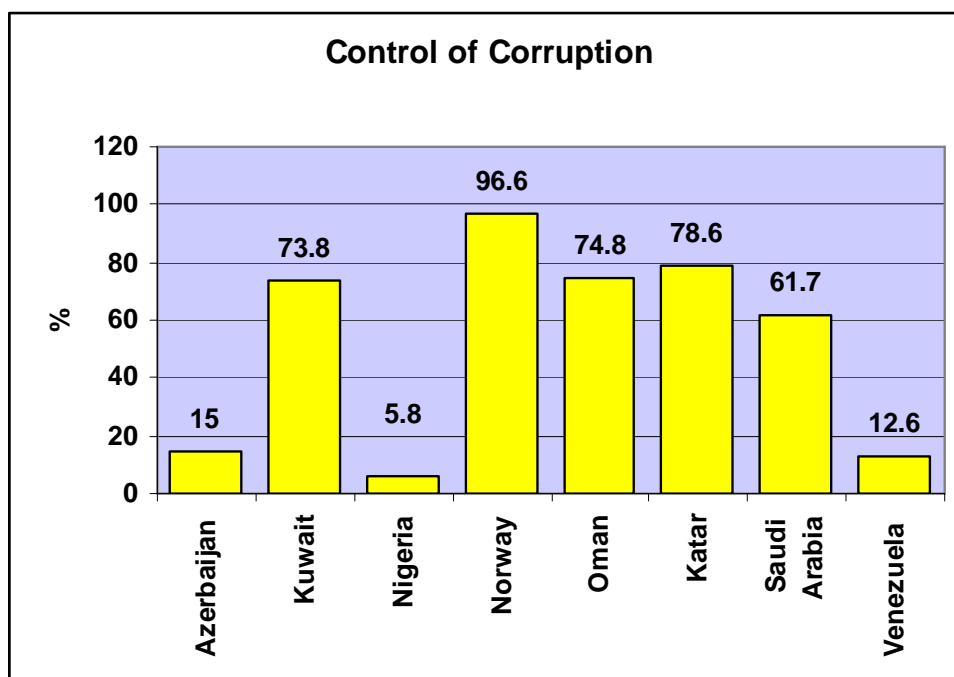
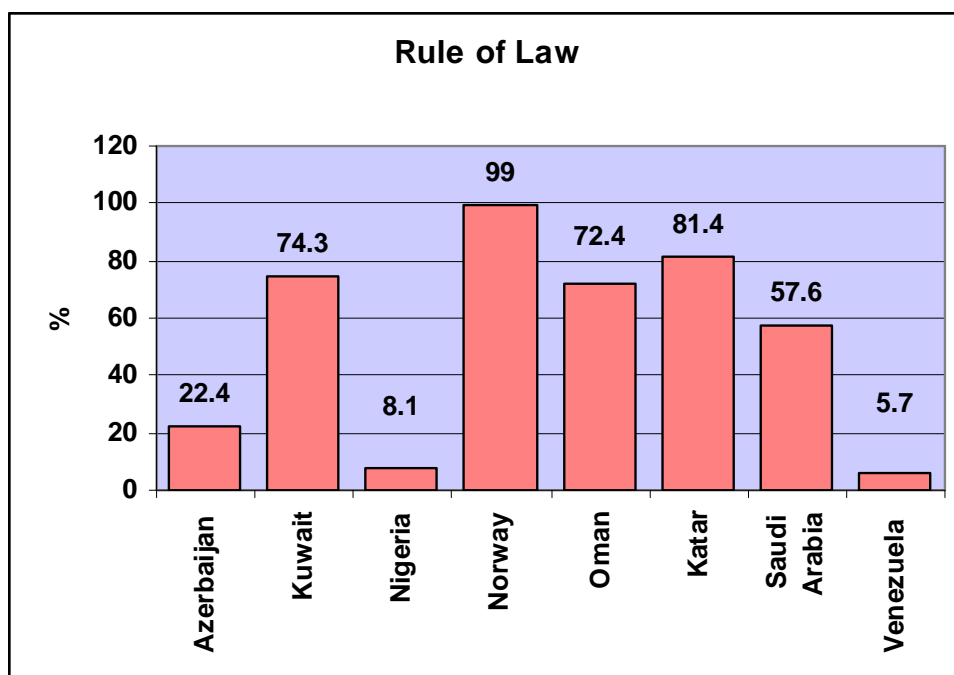


Governance Indicators 1996-2006: Azerbaijan and some oil countries⁴



⁴ http://info.worldbank.org/governance/wgi2007/sc_country.asp





“Roadmap” of Russian reform⁵

Dr. Gregory Yavlinsky

The political struggle is heating up in the country again. This time the struggle is being waged not against communists, but between clans. The clan of old oligarchs (those who obtained large property during the dubious process of privatization, directly participated in politics and governing the country and controlled the most important media in the 1990s) and new oligarchs (those who got hold of powerful “law-enforcement” levers as a result of Putin’s rise to power and use them to redistribute property, engage in politics, run the country and totally control the parliament, the judiciary, the media and elections).

The clan of old oligarchs who replaced politics with covert intrigues, manipulation, ballot-rigging and corruption in all branches of power and brought the incumbent president to the Kremlin as a result are now trying to present themselves as “democrats”. The clan of new oligarchs, who continue exactly the same policy, but in the interests of another group of people, call themselves “a state” and are unsuccessfully carrying out so-called “authoritarian modernization”.

The presence of “professional liberals” in this or that clan, be it public politicians hired by the old oligarchs for decent money or economists placed on prominent positions by the new oligarchs, does not change the state of affairs.

Neither the clan of old oligarchs nor the new ones, setting themselves the task of seizing or keeping power, formulate any goals of public importance for the development of the country in the next 10 years and identify its place in the world and the system of values that will finally allow Russia to identify itself.

This makes us return to the subject of economic and political reforms and put forward an action plan once again.

There are changes, but no reforms

Beginning from the first attempts to make public changes that timidly manifested themselves with the untranslatable euphemism “perestroika” in the second half of the 1980s up to the present day, all talk about “reforms” and the need for them has been in the centre of almost all political discussions, both within the political elite and society as a whole. At the same time, two important issues still remain open: 1) What is the content of reforms the need for which is recognized almost by all active forces of society, and 2) is what is really going on in our society a reform or at least a preparation for them.

⁵ <http://www.viperson.ru/wind.php?ID=293477&soch=1#>

Not every public change is a reform. First, reform, in the general meaning of this word, is a conscious and deliberate change in society according to some well-devised plan. This does not have to be a plan in the bureaucratic meaning of this word – with specific deadlines and people responsible for its implementation (although, in my opinion, there is nothing wrong about such a detailed description of measures and steps, for which I and my colleagues who authored “The 500 Days” used to be criticized). However, in any case, it is necessary to have a clear vision and understanding of the final goals and of what will or should be done in which order and to solve which tasks. Otherwise, this is not a reform, but a simple statement of changes, accidental or natural, that happen without the participation of the political class.

Second, even if reforms are carried out consciously, this is not enough to call them reforms – it is also necessary to make sure that they are aimed at modernizing and making society more complex and comply with some positive goals and ideals that are historically recognized. Otherwise, we would be able to talk, for example, about reforms in Hitler’s Germany or in Cambodia under the “Khmer Rouge”.

From this point of view, there are no reforms in Russia today. There is a government that talks about reforms. There are changes in society. But there are no reforms, because the incumbent government is not engaged in any conscious activity to modernize Russian society and the state. The measures it calls reforms (military, administrative, judiciary, tax, social, housing and so on) cannot bring about fundamental changes in relevant spheres in terms of their modernizing, i.e. in terms of effectiveness, compliance with public tasks and ideals and so on. The positive changes that are taking place are happening with the passive approval of the government at best and in a number of cases, despite the logic of its conscious activity and even with its actual resistance to these changes.

At the same time, objective demand for reforms, a kind of public need for them, not only is not disappearing, but on the contrary, is becoming more and more obvious. Perhaps, this is not so noticeable on the top of the public pyramid where the achievement and satisfaction of private goals or interests creates an illusion of movement in the right direction on the whole. However, the enormity of public problems at the lowest, even median layers can no longer be shielded with small private achievements and success.

What is the goal?

It is also obvious that such a public need will make its way forward even in conditions of the public stagnation that has taken root in recent years and provides for conformism and deviation from active manifestations of protest moods. Despite the whole immaturity and passivity of the main strata and groups of Russian society, the government’s monopoly on active political actions cannot be complete and comprehensive, so sooner or later, the most dissatisfied and active groups from socially and economically active strata of society will inevitably come up as a new political force with a positive agenda.

And then the following issue will arise in all its entirety: what should be done and how in order to avoid a critical development of the situation and ensure the progressive modernization of the economy and society in Russia? Today I see my task in trying to formulate and propose a kind of “roadmap” for future

Russian reforms, without waiting for crises, on the basis of the realities in the country and the world and available, not imaginary, possibilities of the Russian government.

So what do we need for that? First of all, it is necessary to clarify the issue of final goals. The current situation when the lack of a well-established and coherent system of ideas of the country's future is compensated by abstract slogans of "greatness and prosperity" and an amorphous and toothless ideology of "centrism" cannot be tolerated any more. It is necessary to decide what values will be cultivated in our country with its contradictory past and no less contradictory present; what place it will take in the world which will inevitably remain internally divided in the foreseeable future – in 10, 15 or 25 years.

Whether we like it or not, the reality of our time is that the world continues to remain extremely non-uniform – along with the group of countries that concentrate most of the most valuable economic resources, first of all, intellectual and technological, as well as financial and force resources, there exists and will exist a large world periphery that is deprived of access to the main part of benefits which are a result of the use of these resources. For Russia, as a country that is in the "grey area" and has objective prerequisites for moving in different directions, there are only two ways: either to use these prerequisites to try to become part of the core of the world capitalist economy (this way can be called a "European choice" for Russia), or to look for its own place in its periphery. We can cite arguments in favor of this or that argument, but there must be one obvious thing – there is no "third", "Eurasian" or "own" way. The fear to give up part of its sovereignty as an argument against the "European" or "Euro-Atlantic" way for Russia is understandable and partially even well-founded. But the only alternative is a place in the periphery of world developments. It is also inevitably related to the restriction of state sovereignty – not necessarily a formal one, but in essence an even more significant one, because sovereignty and independence make sense only to the extent in which there are practical opportunities for their implementation. (The sovereignty of the weak and dependant – it is like freedom without money: it is there, but you cannot use it).

Compass for reforms

If we look at the differences between the countries of the first group and the others, we cannot but admit that there is a certain set of common basic values that unites them, including first of all the priority of human rights, the right to property, individual freedom and the idea of social justice. We can argue what is primary – these values or economic effectiveness. Is the relative economic prosperity of this group of countries a result of the allegiance of their political elite to these values, or on the contrary, economic welfare creates possibilities for a relatively fuller implementation of principles of personal freedom, security and smoothing out of social inequality? Personally I think that the truth in this argument, as usual, lies somewhere in the middle, but the most important thing is different. Namely: admitting, of course, that it would be counter-productive and simply stupid to try to rearrange public relations in strict compliance with the aforesaid values, we cannot but see that without their formulation as public goals and as a reference point in the process of choosing a strategy, no reforms are possible as a means of modernizing Russian society. The modernization of the state without people and without proclaiming the real priority of the interests of a

specific citizen will inevitably put us in the ranks of poor and rightless nations, i.e. in a situation that is directly opposite to tasks of modernization.

So, the first step on the path of real modernization and effective reforms as its instrument should be the adoption of a human and citizen and his freedoms as basic values: his right to property and at the same time, to social justice; the priority of the institute of law over considerations of political expediency and subjective notions of it among specific people who have power and property. Of course, we are talking not about blind compliance with these principles in all possible situations, but about their adoption as main basic reference points. In other words, the ideas of a law-governed state, civil rights and freedoms and social justice should be a kind of compass for the “roadmap” of Russian reform.

Also, we have to understand soberly that real reforms which we still have to start will not begin from a blank page. The current Russian society is far from being *tabula rasa*, it has its own history, while the reforms themselves have a pre-history in the form of clear events of the last 15 years which combined with the imperial authoritarian and Soviet totalitarian tradition. Respectively, before starting the reforms, it is necessary to identify existing conditions and most importantly, draw a certain line under the current period of Russian history with all its political, social and economic consequences.

Power

First of all, this is the issue of power. The current official authorities in Russia (I am talking not only about the head of state, but also the whole system of state power at all its levels) are a product of 15 years which included repeated colossal political upheavals (it is enough to remember 1991 and 1993), repeated violations of political succession, the fact that the system of organizing state power was drawn up behind the scenes and was actually thrust upon society and its almost permanent rearrangement. Moreover, against this background, the authorities repeatedly lied to society, replaced ideas and denied its commitments to it. All this cannot but affect society’s perception of state power in terms of its legitimacy - not in the form of direct and public disputes over the latter (such things are comparatively easy to foil and control), but in the form of the population’s sceptical and cynical-indifferent attitude to the activity of state institutions and readiness to sabotage any of their decisions. At the same time, the authorities inherited in full the traditions of the previous epoch which were founded by Stalin.

For real reforms, such a situation is a very powerful, if not an insurmountable obstacle. In order for creative reforms to have a chance of success, the population’s trust in state institutes, the authority of the law and state decisions should be significantly higher than what we have today. In other words, state power needs additional legitimization today, giving wider possibilities of access to levers of state power to representatives of political and social groups that are an alternative to the ruling one, in return for guarantees of respect on their part for the foundations of the constitutional system and inviolability of principles of the organization and functioning of the system of power in the country. Moreover, it is necessary to adopt through a compromise a package of laws that would restrict the political influence of major property owners (“de-oligarchization of the government”) by increasing sharply the transparency of the process of adopting

decisions of economic significance and formulating clear foundations that are not liable to double interpretation in order to cancel state decisions adopted in the interests of individual groups and persons bypassing legally established procedures and holding their initiators to account.

Property

Second, this is the issue of property and first of all, the most contradictory issue of large property most of which is related to the results and peculiarities of the privatization of former “socialist” property to this or that extent. It is clear that the degree of its legitimacy is not enough in order to ensure the active participation and cooperation of large businesses in the process of modernization reforms. On the other hand, it is also obvious that the issue of legitimizing privatization and the relations that emerged as a result of it has no simple and clearly correct solution because in this case, the motive of protecting the institute of property runs counter to considerations of social justice which in turn are an important element of the social consensus that is required for successful reform. It is necessary to adopt a special package of laws.

The first part of this package should recognize privatization deals as legitimate (except for those where murders and other serious crimes against people were committed) and introduce a one-off compensation tax for society on extreme revenues - windfall tax. The method of defining and the size of the tax are a subject of discussion. The second part of the package are effective anti-monopoly laws and laws protecting competition, as well as restricting the concentration of capital. The third part are laws on the transparency of financing of political parties, on the transparency of lobbying in the State Duma, in other agencies, on Public TV and a whole number of anti-corruption laws, including restrictions on businessmen, officials and members of government who took advantage of the corrupt privatization of the 1990s.

As is the case with power, the issue of property should be regulated on the basis of some compromise. On the one hand, it would guarantee the inviolability of property owners’ rights as long as they keep to the letter of the law, and on the other, it would form rules of using assets gained as a result of bureaucratic privatization in the interests of society, i.e. on the basis of mechanisms and procedures that do not have market foundations. Specific schemes and options for such rules can be different (for example, turnover rules of these assets and participation among their nominal owners or managing structures of non-residents and any non-transparent structures, etc.). It is important to use rules that will minimize distortions of the motivation of property owners with regard to the effective use of assets at their disposal and at the same time, will make it possible to maintain a certain level of control over their use in terms of their compliance with public goals.

The same principle should be used to legitimize property acquired not only in the process of privatization, but also with significant violations of the tax law. Guarantees of the right to own money and assets acquired in a legal way, but without paying taxes can be provided in return for some restrictions on their use (mandatory, at least temporary, transfer of money to the Russian banking sphere, the post-factum payment of the income tax with an official amnesty for tax violations that were committed and so on).

Also, in connection with events in Ukraine, the term “deprivatization” has appeared. What can we say? The situation in Ukraine and Russia is different, and Ukrainian experience, even if it turns out to be positive, will not be applicable in Russia. A law on the procedure of deprivatization in Russia should be adopted in order to standardize mechanisms of alienating property from its owner who committed especially serious crimes – murders, hostage-taking and so on – in order to get it.

Court

Third, this is the issue of setting up a court of arbitration as an independent institute of economic and political life. Just like any complex sports game cannot be organized without an independent and neutral referee, the economic and political system of a developed society cannot function without an institute of independent arbiters which are state and arbitration courts that cannot be an object of anyone’s sanctions for any reason other than a deviation from the law in the process of issuing a court decision.

The current form of the Russian court system is a product of different public relations – an institute that has been working with different principles for many years and decades and staffed with people who are used to minimum dependence from the law and maximum dependence from powerful political and economic interests. Ignoring this circumstance in the process of planning the process of reforms is an absolutely unacceptable mistake, and the full replacement of judges, just like the staff of the law-enforcement system as a whole, is an option that cannot be implemented technically and politically. For this reason, the mandatory condition here is to draw a kind of line under the past: a kind of amnesty for former “sins” of the judiciary and law-enforcement system, sharply toughening the responsibility of its employees for any future deviations from the letter of the law which should be regarded as serious criminal offences in their case. Such an “amnesty” should mean, for example, that no sanctions can be applied against judges who previously issued illegal sentences. But it should be accompanied with the creation of a mechanism of reconsidering such sentences: their numerous victims are still in prison or have lost their rights. (Remember the “werewolves in epaulettes”? No-one has ever heard that their victims have been rehabilitated.)

After the implementation of the aforesaid preliminary conditions, we will be able to start the process of modernization reforms whose contents are obvious in many respects and for this reason, do not require vast commentaries and substantiations. The main directions and principles of these reforms should be outlined in the following way.

Institutes

The first main direction of well-planned reforms should be the establishment of the institutional structure of a developed society.

As was the case with basic values, the issue of what comes first – the high level of economic development or the institutional infrastructure accompanying it, the basis or the superstructure – has no simple and clear answer. Of course, the process should go in parallel. There is no point in building modern progressive institutes or expecting them to function effectively in a poor and stagnant society. Nor is there

any point in hoping that at some point, economic growth will automatically lead to the appearance of an effective and non-corrupt state apparatus, an independent and competent court system, armed forces and special services worthy of a developed state and a modern education system, not to mention institutes of economic policy, agencies supervising the banking and financial systems, an honest and effective system of social security bodies and social aid, etc.

For this reason, the first task on the agenda of the future reforms should be institutional reforms, the first results of which should become a condition, not a result of doubling GDP and other ambitious tasks in the economic sphere. Specifically, we are talking about reforms in the state service system, not about “administrative reform” as another merger and split of ministries and departments with reshuffles that accompany this process, but about reforms in state service that are meant to change radically the system of motivating the labor of public servants, increase the attractiveness of public service for capable, creative and energetic people and at the same time, sharply increase requirements for the degree of their competence and honesty. Apart from a significant increase in tariff rates, such a reform should include the establishment of a special system of social guarantees for public sector employees, a system of registering and evaluating the experience of previous activities, incentives for career growth which are flawless from a legal point of view, as well as a system of special accountability for employees of this sector for violating the rules that are established for them and norms of ethics of state service. The activities of state agencies should be regulated more thoroughly with a mandatory increase in its transparency and accessibility for civil and parliamentary control.

Then we should talk about serious reforms in the court system. After a line is drawn under the previous activities of employees of this system, the degree and mechanism of the accountability of employees of this system for illegal and legally groundless decisions should be increased several times over, just like accountability for attempts to bribe or put pressure on the courts, including from the executive authorities. The cruelty and what is more important, irreversibility of punishment for any illegal or groundless court decisions should outweigh any benefits or relations related to such decisions, while the mechanism of overseeing court decisions should exclude the possibility of one group of interests or a political force dominating it. At the same time, judges should be granted fair and effective immunity. A mechanism of reviewing illegal sentences handed down earlier should start working in the courts.

Then, of course, it is necessary to adopt, and what’s more important, create mechanisms of implementing a whole number of laws directed at countering corruption and organized crime. Today it is clear (and the experience of the whole world proves it) that it is impossible to overcome this evil, especially if it is in such a neglected state, with ordinary universal methods. To this end, it is necessary to create special agencies and forces that will have adequate possibilities, be armed with instruments and legal support required for that and bear special responsibility for their work. All the necessary skills and experience, including foreign experience, are available. It only remains to demonstrate necessary political will in order to get this process off the ground.

Among the most topical and urgent institutional reforms is the drawing up of a mechanism of protecting freedom of information while toughening accountability for abusing it. Just like in many other

spheres, it is necessary to urgently draw up clear-cut and unambiguous criteria here to legalize restrictions on the dissemination of information and access to it on the one hand, and on the other, to bring to account those who break the law and norms of professional ethics while using this information. Otherwise, society will never manage to break the vicious circle of the lack of information transparency and use of the mass media only as a political and economic tool. The existence of this vicious circle can bury any, even good efforts to implement political and economic reforms.

The long-awaited reform of natural monopolies and the housing complex should also be attributed to institutional reforms. There is an erroneous or deliberate attempt to reduce them to purely organizational changes. The essence of the necessary reform – ensuring openness and transparency for the external supervision of structures working in these spheres – is replaced with endless discussions on organizational reconstruction (merger or split of these structures, creation of new ones, their merger into holdings, regrouping and so on). They might result in anything, but not in increasing the transparency of financial flows circulating in relevant sectors.

Finally, reforms in the system of social, including pension security, as well as reforms in labor relations that are meant to lay the foundations of a modern social state, can also be attributed to this direction. The importance of these reforms cannot be diminished in any circumstances on the basis of the low level of incomes, limited financial possibilities of the state, peculiarities and difficulties of the “transitional period” and so on. I am convinced that the existence of a strong social state today is not only a product of economic development, but also its condition: an unprotected employee; an employee who fears unmotivated dismissal, a ruinous disease and retirement in poverty cannot become a full subject of the post-industrial economy of the new millennium.

Incentives

The second direction within the framework of the proposed “roadmap of Russian reform” should be the creation of a system of incentives for long-term investment and complex forms of modern economic activity. There is no need to persuade me that excessive state interference in the economy is an economic and social evil, a source of ineffectiveness and abuse, the cause of irrational business behavior and a considerable fall in the pace of economic growth in comparison with the potential possibility. However, it is also clear that the correct protection of the system of incentives to keep resources and business energy coming into spheres that suggest the use of technically and organizationally complex schemes, provide for long-term horizons of business planning and increased risks and for this reason, inevitably depend on confidence in a stable beneficial attitude from the state are also the necessary condition for creating a new economy that is competitive within the framework of the modern world economy. The lack of incompetent bureaucratic interference is a necessary condition, but it is clearly not enough for the country to become one of the developed post-industrial economies. Another condition of the sort is, of course, the presence in the country of large civilized businesses which are not so much free from the state as in cooperation with the state on issues where the competitiveness of business in the global economy directly depends on the competitiveness

of the state and its ability to find possibilities of reducing long-term risks and protect national businesses from negative non-market factors. From this point of view, the creation of effective mechanisms of interaction between state institutions and business as a whole, and the creation for businesses of positive incentives and possibilities of adapting to the rapidly changing global economic environment should become an individual and extremely important direction of the process of boosted modernization.

Resources for the future

The third direction of reform should be significant changes to the sectors that are able and meant to provide resources for future economic and social development – to the system of education and organization of scientific research as a sphere that forms the necessary intellectual resources, and to the national financial sector which is a supplier of capital. All talk about the need for serious reforms in these sectors has been going on for quite a long time and there are dozens of draft programs that have been drawn up, but the quantity, and what is more important, the quality of the measures that were really taken makes a depressing impression. As a result, the state of these spheres of crucial importance to future development is absolutely inappropriate to the tasks facing it and is already putting a brake on economic development. It is also obvious that by their very nature, these spheres cannot develop and function beyond the framework of state policy and for this reason, should be in the center of the attention of any program of modernization reforms.

Of course, the list of objects of reformist efforts put out on the agenda as a task of modernization is not limited to what we listed above. For example, the plan of necessary political reforms is an absolutely different subject. Nor was anything said about reforms needed in the sphere of security, foreign policy and public health. Within the framework of each of the directions that were touched upon, we can go further into detail and clarify the list of important tasks and necessary measures. Nevertheless, the main idea of everything that we said above is the thesis that the main reforms are allegedly already behind, and now it is only necessary to develop them and regulate some issues of secondary importance to ensure the country's progressive development. This idea is totally false. True reforms in the real meaning of this word have not even started yet, and in order to start them, it is necessary to go a long and difficult way. In turn, a sober understanding of the situation and clear and unambiguous political will are needed for this purpose.

I also think that if reforms are not really and comprehensively implemented in the next five or 10 years, Russia will finally lose its chances to become a modern developed country, and tendencies of disintegration, as was the case with the Soviet Union, will become insuperable.



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