# The Russian Barter Debate: Implications for Western Policy

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Barter and other closely related forms of non-monetary exchange present a critical challenge for Russian public policy. As of early 1998, from 50 to 70% of exchange in industry took the form of barter, leaving many firms with too little cash to pay salaries and taxes. Both the federal and local governments use non-monetary taxation extensively. In 1997, at least one quarter of the revenue collected for the federal budget took a non-monetary form. Although in early 1998 there was some reduction in this share, after the August crisis non-monetary taxation has once again become prevalent. Since such revenues cannot be used either to make payments on government bonds or to pay salaries to government employees, Russia's fiscal health is even worse than the distressing figures on total levels of tax collection imply.

To date, rich-country policy on this issue has been led by the IMF, which has analyzed the spread of barter and non-monetary taxation as failure of the Russian government's political will to enforce fiscal discipline. Since 1995, Fund policy has therefore focused on ways to infuse the government with resolve by making its lending conditional on elimination of non-monetary taxation. However, Russia has routinely evaded or ignored these conditions.

If they wish to help Russia overcome its barter crisis in a progressive manner, Western countries will need a policy that is far more politically sophisticated. Rather than trying to impose a coercive solution from the outside, rich countries will need to pick sides in an internal Russian debate on how to overcome barter. Continued advocacy of prior policies will at best render rich-country aid and advice irrelevant. At worst, it risks strengthening the hand of those proposing dangerous inflationary solutions to the barter problem.

This memo briefly analyzes the roots of barter and non-monetary taxation as well as contending Russian approaches to their elimination. It then addresses the effects of the August crisis, concluding with suggestions for policy.

### Roots of Barter and Non-Monetary Taxation--Price Stickiness

Russian barter is a way of lowering prices de facto while keeping them the same formally. When a customer can't afford to pay full money price, sellers allow them to pay in kind instead, effectively giving them a price cut. The transaction is booked, however, at the full money price.

Another way of saying this is that Russia has two currencies: rubles and "bartles." A bartle is worth less than a ruble. If a seller allows customer A to pay 10 rubles and customer B to pay 10 bartles (i.e., to pay in kind), customer B has gotten a discount. The payments of both A and B count in the books as 10 rubles, however. Similarly, when Russian firms pay their workers in goods, as often happens, they are cutting worker salaries, although formally the wage bill has been paid in full. When the government takes in non-monetary taxes, it is reducing taxes for firms allowed to pay in bartles.

Why don't these price declines just take place explicitly? Prices everywhere are "sticky downwards," but in Russia's case this is especially so. Power company prices are set by regulatory agencies; other businesses are prohibited by law from selling below their cost of production, and production costs as defined in Russian accounting are often needlessly high. Russian officials are reluctant to relax these rules to allow firms to set prices as low as they want, because they fear this will allow firms to pretend for tax purposes to have sold goods for less than their actual price. Barter allows firms to cut prices de facto while formally charging a mark-up above their "cost of production." Tax authorities also use bartles to get around rigidities: tax rates are supposed to be the same for all taxpayers, but accepting bartles as if they were rubles makes tax rates more flexible.

**Russian Proposals to Eliminate Barter**

There are three Russian approaches to getting rid of barter, which vary according to their analysis of the meaning of the simultaneous circulation of bartles and rubles. Each approach has different political backing.

- *Be Tough:* Some think that bartles hide subsidies to inefficient firms (the "virtual economy" thesis), kickbacks accepted by crooked factory managers, and/or ad hoc tax breaks handed out by corrupt bureaucrats. They argue that firms must operate only in rubles or be forced into bankruptcy, and are supporters of IMF policy.

  *Key backers*: Few beyond liberal technocrats, though occasional tacit support is given by Moscow-based banks that hope to expand their industrial empires by snatching up firms forced into bankruptcy.

- *Be Flexible:* Another argument is that bartles allow firms to do what firms everywhere do: cut prices when necessary to make more sales and more profits. Accepting bartle taxes is a way that government prevents the overbilling that would result when firms' receipts are in bartles but they are taxed as if they had earned higher-valued rubles. To eliminate barter, laws making prices rigid should be repealed. Lower prices for key inputs and an end to the expensive hassles of barter will make Russian firms more competitive and promote economic growth.

  *Key backers*: The huge natural gas company Gazprom, which sees Russian consumers as central to its future but knows they can't afford the prices it charges Europeans; the Railways Ministry, which benefits from increased traffic when it can cut prices; as well as other firms making ends meet in the barter economy, but tired of its difficulties.

- *Be Soviet*: A third school thinks the value of bartles and the value of rubles is really the same. Russian firms use bartles not to give price cuts but because the government prints too few rubles to service transactions. The government should replace bartles with rubles by printing money to service all legitimate transactions. What counts as a legitimate transaction should be determined by close state supervision, moving back towards a command economy.

  *Key backers*: Communist Party, defense industries and other firms not making ends meet in either the ruble or in the bartle economies.

**Political Effects of the August Crisis**

Supporters of a "Soviet" solution, though strong in the Duma, were economically weak and largely marginal until the August 1998 crisis. Anti-barter policy was contested by advocates of toughness and of flexibility, who fought to a stalemate. Get-tough policies were stymied by effective resistance from both Gazprom and provincial governments defending local industry. Flexibility advocates had some limited successes in changing government policy, but the lasting political accommodation needed for a sustained effort was continually undermined by IMF conditionality demands for a tougher approach, especially toward Gazprom. Such demands were especially a problem for the Kiriyenko government, which intended to implement policies allowing more flexibility, but instead embarked on needless conflicts with Gazprom in an effort to win IMF credits.

The August crisis led to a complete political and economic rout of advocates of a get-tough policy. Liberal technocrats left the government, and the Moscow-based banks were financially ruined. Meanwhile, advocates of the Soviet approach grew much stronger, as their financial weakness came to matter less (given the general crisis) while their strength in the Duma began to matter more.

**Implications for Western Policy**

Wherever the truth lies in the economic analysis of barter, politically speaking, in supporting advocates of a get-tough approach to barter, the IMF backed a horse that could not win. That horse is now dead. But those remaining are not all the same color. The struggle over barter now pits those who hope to eliminate it through a more flexible price mechanism against those who want to eliminate it by combining the inflationary money issue with heavy-handed government control of industry. In other words, at issue is whether barter is evidence of a market that is working badly--or evidence that markets don't work at all. Supporting the "continuation of reform" means aiding advocates of a price flexibility solution to barter, rather than continuing to cling to old get-tough policies that no longer have any political base whatsoever.

In particular, three long-standing IMF policies will need to be reversed.

- Don't make financial assistance conditional on a rapid elimination of non-monetary taxation.

Getting rid of barter by making the price system more flexible will be a slow and difficult process, given the extent to which multiple "bartles"--each with its own specific value and patterns of circulation--have already become institutionalized. In the short term, taxation in kind will need to continue, reflecting differences of value between bartles and rubles. A policy that recognizes these differences of value should be preferred to one that drowns them in a flood of new money.

- Don't try to bring Russian domestic energy prices to "world levels."

Russian consumers can't afford these prices (which are hard to define anyway), leading to price cuts given by accepting bartles instead of rubles. Gazprom and to some extent other energy producers have themselves sought to charge lower prices for domestic consumers, not because they are eager to subsidize them but because this policy makes commercial sense--more customers, lower unit costs, more profits. Trying to push energy firms (and the railways) to charge more than they feel is in their commercial best interests, as the IMF has done, will either lead to continued use of barter as a price-cut mechanism, or to inflationary handouts to customers to allow them to pay these prices. The IMF needs to stop making assistance conditional on price policy in these key sectors.

- Promote centralization in the natural gas, electric power, and railway sectors.

Up to now, the IMF has sought to push the reorganization of all three of these sectors to allow competition from different providers. Although it may be that there would be some long-term efficiency benefits from such a reorganization, it is not an open-and-shut case, and many capitalist countries do not run these sectors on a fully competitive model. At a minimum, marketization can wait. The more urgent priority is centralization, which makes possible the coordinated price policies that can overcome the use of barter to change prices. In fact, the railways and Gazprom have been able to run more coherent anti-barter policies than the less centralized electric power sector, though barter still dominates all three sectors.

These suggested policies do not seem "pro-market" on their face. However, in context, they will work to strengthen the supporters of the most basic principle of markets: that the purpose of business and industry is to make money by getting consumers to make voluntary purchases. Rejecting these policies would weaken the last powerful supporters of this principle, and make it harder for Russia to pursue the elimination of barter through increasing price flexibility. The likely result would be the victory of those who believe that consumer demand is irrelevant, that industry exists to make things rather than to make money, and that barter should be eliminated through inflationary monetary issue. The rich countries can no longer afford the illusion that they can impose policies on Russia regardless of their domestic support. They must look to the actual contending political forces, and decide which one they prefer.