



BOFIT Online

1999 • No. 12

Vladimir Mau

Russian Economic Reforms
as Perceived by Western Critics

Bank of Finland
Institute for Economies in Transition
BOFIT

ISSN 1456-811X (online)
31.12.1999

Bank of Finland
Institute for Economies in Transition (BOFIT)
Helsinki 1999

The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

Contents

Abstract.....	4
Introduction	5
SECTION 1. The Failure of Russian Economic Reforms	6
1 The Chinese Experience Has Been Ignored	6
2 The Role of Financial Stabilization.....	8
3 Russian Privatization Experience.....	10
4 Roots of the Reformers' Errors: the Professors' Approach.....	12
SECTION 2. Post-Communist Transformation in Russia as Special Case...	17
1 A Weak State and the Revolution	17
2 The Beginning of the Post-Communist Reforms: Jacobins, Bolsheviks, and Contemporary Russia	18
3 Privatization with a weak state.....	21
Bibliography	25
Notes	27

Vladimir Mau

Russian Economic Reforms as Perceived by Western Critics

Abstract

It has recently become customary to argue that Russian economic transformation since 1991 has failed because of bad policy advice and mistaken policy choices. Though Russia's performance leaves much to be desired, such criticisms are based on a failure to analyse the real choices available to reformers in the post-perestroika period. The paper, criticising in particular the views presented by Joseph Stiglitz, shows that the Chinese reform path was not available to Russia, that mass privatisation was influenced more by political necessity than theoretical choice, and also discusses the relation between doctrine and necessity in policy making more generally. The final section of the paper characterises Russia as a case of weak state, and identifies several of the consequences arising.

Keywords: Russia – economic policies and transformation; political economy of reform and revolution.

Introduction

The slow economic development of post-communist Russia has been widely and negatively discussed by Western economists. To oppose Russian economic reforms now is as fashionable and popular, as to argue against fat and cholesterol in the United States, or, even worse, to say a good word about these reforms is as dangerous as to flatter a feminist. In fact, opposing Russian reform has become a popular trend, and any attempt to justify or explain the events in Russia or to underline Russian achievements falls on deaf ears. My own experience shows that when offering a balanced, non-emotional analysis of events in 1990s Russia, this results in my listeners' confusion and incredulity followed by sneering questions like "We thought that the oligarchs had robbed the country?" or "Yeltsin is an alcoholic, isn't he?" (In similar fashion, in Stalin's USSR any positive example of American life was proudly met with the retort "Yes, but they lynch Blacks, don't they?").

It goes without saying that Russian reform cannot be assessed as very successful. However, it is important that the reform program be thoroughly assessed and professionally analyzed without bias. This analysis differs radically from today's typical political statements, or pseudo-academic rhetoric, where the knowledge of real facts and events is replaced by deep (or not very deep) knowledge of theory.

Among recent publications, an article written by Joseph Stiglitz, "Whither Reform?"¹, and a number of publications in the *Transition*² journal support and perpetuate this negative viewpoint. The fact that Stiglitz is a world-renowned economist whose books are widely read further frustrates the situation. In regards to *Transition* magazine, in the first half of the 1990s, this magazine was very popular among Russian reformers; since then it has joined the long list of criticism-oriented publications³.

Fashion matters, and for the latest critics only black color exists, and any changes can only deteriorate the situation. This metaphor represents the typical approach to Russian developments nowadays. But trends, if left unexamined seriously, can easily become absurd. For example, the following extract was culled from an established work written by Richard Rose in spring 1999 regarding the results of public opinion surveys made in spring 1998: "The New Russian Economic Barometer survey found that in early spring 1998, three out of five Russians routinely did not receive the wages or pension to which they were entitled; this number has *certainly* increased since the financial collapse of last August [1998]" (Rose 1999, p. 9, italics mine – VM). This type of *post factum* forecast reflects a predetermined belief that no other scenario is suitable for Russia – things can *certainly* change only from bad to worse. However, available statistical data illustrates quite the opposite: after the crisis and, probably, due to the crisis, debts on wages and pensions have been decreasing rapidly.

In the first part of this article, we intend to briefly discuss and comment on a number of the most widespread criticisms of Russian reforms and Russian reformers. In the second part of the article, we will point out several significant peculiarities of Russia's post-communist transformation that have not been taken into consideration by western economists. Due to the size of this article, however, we cannot analyze every reproach or list every argument favoring the alternative point of view. All we ask is that our readers pay attention to studies (performed by us or our colleagues) that analyze the appropriate issues in detail. The fact that many publications denigrating Russia's experience lack information regarding the Russian reforms makes this exercise a crucial one.

There are many theories as to why Russian reforms were not successful, and many reasons to blame Russian reformers. Let's discuss the most significant ones.

SECTION 1. The Failure of Russian Economic Reforms

1 The Chinese Experience Has Been Ignored

At the beginning, this issue of failing to learn from the Chinese experience was mostly raised by traditional Soviet *nomenklatura* with a moderate drive for reforms. Currently, this theory is getting more and more popular among western economists. (As an example, see Intriligator, 1996). The argument that Russia ignored the Chinese experience uncovers the roots of many errors and distortions related to the character and mechanisms of post-communist Russian reforms.

Those critics in the traditional Soviet *nomenklatura* could see that the Chinese path would not only have preserved, but also would have stabilized its political and economic power at least for another couple of decades. The most energetic advocate for the Chinese way of development was Arkady Volsky, named the “Russian Deng Xiaoping” in the early 1990s. The same argument fit perfectly the rhetoric of Yevgeny Primakov, another candidate for this “flattering” title. Finally, a theoretical justification for this thesis was stressed by the members of Economic Section of the Russian Academy of Sciences. Many of these critics laid foundations for Gorbachev’s reforms (among them academicians Leonid Abalkin, Oleg Bogomolov and Dmitry Lvov).

It is clear that the Chinese way entails leaving power in the hands of an old *nomenclature* in order to preserve a one-party system and the ideological purity of a regime. Economic transformations then are to be undertaken gradually, under a *nomenclature* control. Any attempt to increase the political activity of individuals must be heavily suppressed.

The fact that Western economists, who have been brought up in the tradition of political democracy and “political correctness,” regret that the Chinese experience was not used, is vexing.⁴ We would like to present several arguments from both an economic and sociopolitical nature that underline the reasons the Chinese experience is not applicable for modern Russia.

Politically, the situation which made China’s experience irrelevant to post-communist Russia is so clear, that it is quite strange to repeat such well-known facts. Key to the Chinese model is the availability of a totalitarian regime capable of controlling all situations in the country through their party and intelligence services. The liberal reforms that began in Russia in 1991-1992 were launched at a time when not only was there no strong state; there was no state at all. The USSR had been already dissolved, and Russian sovereignty existed only on paper.

Perhaps all the responsibility regarding ignorance of the Chinese experience should be addressed to Michail Gorbachev and his Prime Minister, Nikolai Ryzhkov, as well as domestic advocates of this “Chinese type” program (most of them were integrated into a party-Soviet elite (*nomenklatura*) and were directly involved in the strategic planning of the economic development of the USSR). However, even such reproaches are rather groundless. It is not difficult to demonstrate that the social and economic conditions of the USSR in the 1980s were dramatically different from the conditions in China before and after its reforms.

The social and economic structure of Chinese society is similar to that of Soviet society, however not in ‘80s, but in ‘20s, during the NEP (the New Economic Policy) era. Indeed, the ratio of urban to rural population, the GNP and employment structure, the literacy rate, social security system and, respectively, the GNP per capita and budget burden on the economy (budget share in the GNP) correlated to the above mentioned indicators coincide significantly between the USSR of the 1920s and 1930s and the China of the ‘80s and ‘90s.

(Without going into a lot of details, we would like to propose that the Chinese transformation may suggest how Russia could have been industrialized during the NEP period in a “softer” way⁵.)

To implement the model of accelerated economic development while preserving a totalitarian regime, three conditions are important. First, economic development should be set at a low level because a significant number of the labor force is not actively involved in production (i.e., there is rural overpopulation). Second, social development should be set at a low level (note that the level of the state’s social responsibilities is not the same as in developed societies; for example, the Chinese social security and pension provision system covers no more than 20% of its population, compared to the one in the USSR which covered the whole population). Third, there is a low cultural and educational level and the demand for democratization of the society is not an important issue among the bulk of the population⁶.

These factors are all currently present in China - and none of them existed in the Soviet Union of the 1980’s. In fact, anyone who regrets that Gorbachev did not follow Deng Xiaoping’s way or who recommended that Russia learn from China must then agree with the following prerequisites: First and foremost, the government shall reject its social responsibilities and stop paying for pensions and social benefits; then, second, the government shall cut the provision of free education and health services; and third, the government shall adjust the level of budget burden in GDP from the current 35% to approximately 20-25%⁷. However, as far as we know, advocates of the Chinese recipe to a large extent are motivated by the deteriorating social situation in Russia and demand its improvement. This means, that their recommendations then are not based on a realistic economic policy but on useless dreams “to make all thing better”⁸.

We do not want to get bogged down with the question of whether the initial conditions in China were more or less favorable compared to the USSR at the beginning of its restructuring. That question needs to be discussed separately. The statement, “China’s challenges were greater for it had to manage the challenges of transition and of development simultaneously” (Stiglitz 1999, p. 3) is irrelevant to the Russian situation. The Soviet Union did not only have to reorient its labor production toward a market direction, but also had to implement deep structural reform in order to transform an industrial economy into a post-industrial one. To form new sectors of the economy having an existing industrial system with its priorities and powerful groups of interests is to say the least not less difficult than the creation of modern industrial sectors.

The development of democracy was equally complicated. The Soviet society of the 1980s was mature and educated enough, and the country was relatively open to a Western style of life. Therefore, the population accepted the reforming initiative of the Party’s leadership without political adjustments. Because of the experiences of the 1960’s (when the USSR leadership rejected economic reforms and suppressed reforms in Czechoslovakia), nobody would believe that the intentions of the Party’s leaders were serious. The population viewed the statements about reforms as a provocation by the State security service (the famous KGB) to test the loyalty of the citizens. Only because the Government was ready for real political change were the leaders able to induce economic reforms; and, at the same time, they were able to silence the majority of party leaders who considered Gorbachev’s initiatives an imprudent annoyance (for more details, see Mau 1999).

Thus, all the arguments that economic reforms should have been undertaken beforehand and only followed by political reforms, democratic development, freedom of speech, and liberalization of political prisoners are groundless in regards to Russia. The arguments are incorrect from a political-economic point of view and amoral to boot⁹. Any appeal to turn

to the Chinese model implies strengthening the totalitarian character of society, and to catalyze a neo-communist reaction. It is not irrelevant that many people treated the letter containing the corresponding proposals (published on July 1, 1996 before the second round of the presidential elections) and written by a number of famous economists from Russia and the USA (Abalkin et al, 1996), as a declaration to support the candidate from the Communist Party of the Russian Federation.

2 The Role of Financial Stabilization

The other criticism frequently extended to the Russian reformers addresses their fascination with macroeconomics (or, to be more accurate, with the issues of financial stabilization) and not with the implementation of institutional reforms. It has been said that “shock therapy” devastated the population’s savings and decreased consumer demand which, in turn, formed the conditions for a sharp production decline and privatization distortions. In addition, there is the thesis dealing with the harmful nature of a created internal debt system, the notorious GKO pyramid. “What was worse for Russian economy was the government’s pursuit of a policy of macro-economic stabilization” (Brovkin 1999, p.22). This echoes the typical statements in literature regarding Russia.

With all the many criticisms and reproaches, the voices of different critics create a single choir, though they are often talking about different things. The most educated and the least politically engaged economists assert that the fascination with macro-economic stabilization has set aside a plan for institutional reforms. They argue that institutional reforms were not part of the overall reform plan as they should have been; and that they also could have been undertaken with the same “shock therapy” methods (Stiglitz, 1998; Stiglitz, 1999, p.21). Others believe that macro-economic stabilization was a mistake because the stabilization led to an overrated exchange rate, which, in turn, devastated domestic producers. (Brovkin 1999, pp. 22-23). Finally, there are writers convinced in a harmful nature of a macro-economic stabilization policy (in other words, financial stabilization, or “shock therapy”) as is¹⁰. It is interesting that advocates for the latter approach often mention such authorities as Joseph Stiglitz or Kenneth Arrow as if they had also considered a decisive stabilization policy dangerous and distracting¹¹.

Thus, there are several issues incorrectly mixed together: the expedience of a shock therapy policy, factors predetermining the transition to such a policy, concrete mechanisms to implement macro-economic stabilization, the ratio between macro-economic stabilization and institutional reforms, and the more general issue dealing with a sequence (consistency) of economic reforms after the collapse of Communism.

If shock therapy implies a decisive and rapid macro-economic stabilization with an achieved price and budget equilibrium, inflation freeze, and the national currency transformed into a tool for economic agents to perform their transactions, such a policy was just partially implemented in Russia. The most important achievement of the first phase of economic reform was that the goods shortage was overcome, the threat of hunger in the winter of 1991-1992 was avoided, and the ruble became convertible in current accounts. Such an accomplishment is not inconsequential for a country with a 60-year history of goods shortages and criminal punishment for hard currency transactions. But, it is not enough to be labeled with the a somewhat exotic label of “shock therapy”. It took four (!) more years for the ruble to acquire some kind of stability - it happened in 1996. It took three more years for the country

to achieve at least the primary balance of its budget – it happened in 1999. Altogether, it took seven years to resolve the very first tasks of a macro-economic stabilization. What a shocking therapy it was!

Shock therapy is frequently understood not as a specific logical type of economic policy with set results, but by the painful consequences of macro-economic decisions such as the jump of prices and unemployment rates, the growth of poor population and social stratification, sometimes even by the decline of the demographic situation¹². Emotional writers consistently interconnect all of these social disadvantages and problems with the liberalization and stabilization measures undertaken during the first post-communist governments. In fact, the social adjustment burden was the result of the financial crisis at the moment of entering a post-communist epoch, and not of the stabilization policy as such. In other words, the shock-therapy nature of the stabilization program was, for the most part, predetermined by the policy of the last Communist government, and not by the reformers. The most unbalanced economies were in the countries of the former Soviet Union and Poland; and those were the countries where “shock therapy” was implemented¹³. In regards to Hungary and Czechoslovakia, their last communist governments pursued a rather cautious financial policy. After the change from their communist regimes, the changes in corresponding economic indicators were much more moderate. Therefore, it was not as difficult a task to implement stabilization measures there, especially in the social and political regard¹⁴.

Table 1. Budget deficit/surplus (-/+ % GDP) and the inflation growth (% of a previous year) before and after the onset of post-communist reforms.

	1989	1990	1991	1992	1993	1994
Russia						
Budget	-8.6	-10.3	-30.9	-29.4	-9.8	-11.8
Inflation	1.9	5.0	161	2506	840	204.4
Poland						
Budget	-7.4	3.1	-6.7	-6.7	-3.1	-3.1
Inflation	247	249	60.4	44.3	37.6	29.4
Hungary						
Budget	-0.2	-1.4	0.4	-2.9	-6.8	-5.5
Inflation	16.7	16.9	33.4	32.2	21.6	21.1
Czech Republic						
Budget	-2.8	0.1	-1.9	-3.1	0.5	-1.2
Inflation		18.4	58.3	9.1	25.1	11.7

Sources: World Bank (1992); Gaidar (1998); Sinelnikov (1995).

It was not the shock therapy program but the refusal to stick to it that catalyzed many contradictions in Russia's post-communist development, including its institutional problems. The decline of investments, the lack of interest of foreign businesses in Russian enterprises, the unstable conditions for production, and the many defects of privatization are all associated with long overdue and incomplete financial stabilization processes. It was not the monetary stabilization per se that fueled the dollarization of savings and transactions, the currency appreciation, and the contraction of output (as claimed, for example, by Brovkin, 1999, p. 23)¹⁵.

It is not only inflation that is unfavorable for investments, and several examples exist in which investments and the growth of the economy occur while inflation approaches 100% per annum. There is another and more complicated mechanism that appears to foster institutional limitations on economic activities. As Yegor Gaidar points out (1997), in a post-communist country there is a clear connection between the duration of a high inflation period and the depth of a budget crisis. The longer there is high inflation, the stronger is the addiction of the government and the economy to an inflation tax; the more inflation tax, the further the tax system degenerates. Thus, it was an incomplete (or, unrealized) state of shock therapy that caused the sensitive erosion of resources available to the budget, the crisis of the budget sphere, and the necessity of internal borrowings in the form of GKO's. In addition, it was the budget deficit that spurred a strong appreciation in the ruble exchange rate¹⁶. A stable national currency was necessary to solve the budget problems through internal borrowing mechanisms. Furthermore, the more the budget depended on the financial market the less the government could maneuver.

To summarize, it might be said that incomplete macro-economic stabilization and an inability of reformers to realize "shock therapy" measures dramatically aggravated a budget system in crisis – both in terms of expenditures and income. This, in turn, set in motion a deep crisis within institutions and of the government power structures themselves.

Often shock therapy is criticized because reforms are undertaken in the wrong sequence¹⁷. It is said that institutional reforms and privatization should take place first, and liberalization and stabilization should take place later. This may be correct in terms of logical speculations, but the experiences of those countries that undertook market reforms does not provide a single case to prove such a concept viable. (In fact, there are still Northern Korea and Cuba, which sooner or later must also undertake market reforms and maybe prove another sequence of events).

We cannot help but admit that Joseph Stiglitz was right when he pointed out the correlation between "shock therapy" and institutional reforms. In fact, institutions building takes significant time; they cannot be created by a "blitzkrieg" methodology (Stiglitz 1999, p. 21). However, simply because this or that model seems justified theoretically, does not guarantee that it can be practically implemented. Keeping this point in mind is important in the analysis of Russian privatization.

3 Russian Privatization Experience

The results of Russian privatization currently is unanimously negatively scored, while the score was unanimously positive during the first years of its implementation. The responsibility for this failure roots itself in the same characteristics that everybody initially applauded: the rapid and "massive" nature of the privatization program in Russia¹⁸.

Critics address these reproaches to the Russian privatization program. First, privatization was implemented too rapidly without appropriate institutional preparation and legislation. Second, privatization weakened state power, eroded public order, and fueled corruption. Third, privatization did not create real owners of property; in fact, all (or almost all) the property that was privatized had a criminal element. Defects in the voucher mechanism, the personal desire of the reformers to accelerate the break with Communism, and sometimes their dishonesty – all these arguments are used to explain why privatization did not work properly.

Now there are suggestions that the privatization process should have been undertaken gradually and in parallel with the creation of appropriate market institutions that would have secured a longer period for state control over property and its proper usage. There are also suggestions of other privatization mechanisms; for example, privatization in favor of stakeholders or leasing mechanisms (to rent with the right to purchase). Unfortunately, all of these suggestions do not take into consideration the economic, political, and legal realities that existed at the beginning of the privatization process in Russia.

Let's discuss those "miserable" vouchers. Yegor Gaidar, Anatoly Chubais, and their colleagues were against free distribution of property through privatization checks¹⁹. Initially, they considered a gradual privatization for cash to be necessary. However, the real conditions of the early 1990s dictated a different approach. On June 3 1991 the law "On Privatization of State and Municipal Enterprises" was adopted. This law established the legal basis for privatization in Russia. It was this law that prescribed individual privatization accounts, in essence a non-cash mechanism of privatization. It soon became clear that such a system was inefficient and vulnerable to corruption. The intention of reformers was to cancel it. However, in the process of negotiations with the legislature, the negotiators reached a compromise to keep privatization checks but to make them impersonal. It was impossible to consider a total rejection of non-monetary privatization mechanisms²⁰.

The speed of privatization became also a very critical issue. Nowadays, one can discuss whether it would have been more reasonable to leave the majority of enterprises as state properties, and gradually perform a case-by-case privatization. In reality, the state did not have any control over "its" property, which *de facto* was being controlled by management. After 1988 the process of "spontaneous privatization"²¹ started gaining momentum. Spontaneous privatization is a euphemism for the transferal of state property into the hands of those who use it. It was initiated by the USSR Law on State Enterprises (June 30, 1987). In accordance with that law, labor collectives (in fact, directors, managers) became independent from the state. Directors obtained the rights of owners, but the responsibilities for their enterprise were left with the state. The Law on Cooperation (1988) adopted soon after also created a mechanism for mistreating the property: to establish cooperatives within enterprises. These cooperatives performed the most lucrative activities for their enterprises or used the difference between the state (at the enterprise) and market (at the cooperative) prices in their favor. The difference (profits) went to the managers (who or whose relatives were the owners of cooperative)²².

A "spontaneous privatization" is also characteristic of the right given to labor collectives to purchase rented enterprises. Taking into consideration reasonable theoretical thoughts, Joseph Stiglitz opposes a rapid voucher privatization and prefers a solid, non-speedy mechanism to transfer lease-based enterprises (one that are to be rented with a right to purchase, or lease-with-purchase deal). Furthermore, as an example of Gorbachev's institutional incrementalism, he points directly to "renting with a purchase right". According to Stiglitz, the so-called reformers (which is, again, his expression) should have adhered to such a model. (Stiglitz 1999, p.24). But it is well known in Russia that one of the arguments leading to rapid voucher privatization was the spread of the "lease-with-purchase" system. This system in the vast majority of cases served as an instrument for managers to obtain the property of their enterprises for free.

The reality was very different from what its critics saw. Accelerated privatization in Russia was not a mechanism to take the state out of the economy, but an attempt of the state to catch the last coach of a departing train named "socialist property". The privatization program, though it had its own problems, facilitated the restoration of some order of property management, and brought some order to the whole sphere of society.

As he does not take into account the initial lack of real mechanisms of state control over property, the apparent contradictions in Stiglitz's paper are unavoidable. On the one hand, he asserts that control over directors of state enterprises could be considered as an alternative to an accelerated privatization (p. 15). On the other hand, even presently it is clear that the state is unable to regulate the activities of the fund managers efficiently (p.16). It should be noted that in the first case we are talking about hundreds of thousands of enterprises in a collapsing state (the beginning of the 1990s) and in the latter case we are only discussing several dozen funds.

At last, I must comment on the main proposal made by Stiglitz that recommends undertaking the privatization in favor of the stakeholders, and to applying the principles of businesses managed by an owner or a family firm to medium and large companies. (Stiglitz 1999, p. 18). What he is recommending is privatization in favor of an enterprise's employees: they "are not alienated passive shareholders who view their enterprise as a "property" only (which gives them a chance to harvest fruits)". (Stiglitz 1999, p. 18-19). Such theories, however, base themselves on limited knowledge of both the Russian privatization experience and the functioning of the companies in Russia. First and foremost, a great majority of Russian enterprises had been privatized in favor of labor collectives, which hardly facilitated the transformation of the latter into efficient owners. In the contrary, the privatization in favor of employees helped directors to obtain full control over their enterprises; in fact, from the very beginning, with threats to fire (if voting did not go their way), and then, legally (with employees selling their shares voluntarily or under duress). As a result, such a proposed privatization mechanism facilitates the process of "selling and stealing assets, which leads to an enterprise's collapse" even more (Stiglitz 1999, p. 17). Thus, we see no proof that "privatization in favor of stakeholders" is capable of showing better results²³.

4 Roots of the Reformers' Errors: the Professors' Approach

Another set of criticisms directed at Russian reformers targets the various sources of their mistakes. They discuss those errors that underlie the above-mentioned defects in Russia's economic policy during the last decade. It is their perception of Russian reformers' mistakes that uncovers the roots of many misunderstandings and confusions; misunderstandings that are unusual for serious economists.

The theoretical and ideological preferences of those who led the government at the beginning of the reforms are often considered as the main reason behind their poor results. The following issues, according to critics, contributed to the lack of success of the Russian economic reforms of the 1990's.

First and foremost, the reformers are accused of being fascinated with theoretical models they had studied from textbooks, and that those textbooks were not of the best quality. Joseph Stiglitz is adamant regarding the reasons for the Russian reforms' failure as "a failure to understand what makes an actual market economy function – a failure arising in part from the neoclassical model itself". The reformers "were overly influenced by the simplistic textbook models of the market economy" (Stiglitz 1999, p. 4).

Second, the ideological prejudice of the reformers, along with their wish to finish with the communist past and its inherited institutions determined their desire to demolish those institutions rapidly and without an immediate substitute. But as the Chinese experience also proves, poor existing institutions are better than none at all.

The third reason for those mistakes was inadequate advice from foreign experts (mostly American, as Western European critics like to stress) who were actively working with the Russian government during the first post-communist years. Their role is usually considered as the reason for such defects in the Russian model as “shock therapy” and excessive attention to macro-economics, privatization, and strict monetary stabilization. “No one can dispute that shock therapy was a Western product imposed on Russia by Western advisors and their Russian students” (Brovkin 1999, p. 22). This thesis is asserted by almost any solid sovietologist paper.

In addition to the latter argument, there is criticism of international financial institutions, who imposed inadequate reforms on Russia and provided bad advice. This criticism is based upon the “Washington consensus” (Stiglitz 1997, 1999)²⁴.

Finally, the “vicious” character of the last decade of the ‘90s (imposed by the West, the IMF, etc.) is explained by the lack of understanding of historical, cultural, national, etc. traditions of Russia, with its glamorous past and heroic present times.

Knowledge of Russian and especially Soviet history is reckoned as the key to understanding how to reform the economy. Sovietology in this logic becomes the main trustee and source of wisdom for a post-communist country. Those researchers with a strong background in the Soviet economy should be looked upon as genuine experts regarding Russia²⁵. These researchers include sovietologists who were completely unable to assess the real contradictions of the Soviet system and to forecast its development within Gorbachev’s *perestroika*. That is why they were offended by Russian reforms. Most of them did not understand and still do not want to understand the real problems and the logic of a post-communist economy.

All of these factors are closely intertwined by both logic and methodology. All of them are based on a very special, misguided approach to economic policy decision making. Such an unfounded approach includes the following components. First, an economic policy is the result of a plan worked out in an academic setting. Second, there are correct and incorrect (right or wrong) economic theories. Third, an economic theory directly influences market behavior. Fourth, economic advisors must give advice, and politicians must implement what is advised to them.

Alas, all the aforementioned arguments and factors base themselves on total misunderstanding. When critics say that it is impossible to develop an economic policy based on certain textbooks and theories, they immediately offer other textbooks and theories. For example, all the reform failures appear to be caused by the fact that the books of Keynes, Schumpeter, and Hayek were ignored. The textbooks on economic theory that focus on information economics instead of a “genuine” neoclassical approach were not appreciated enough either; the reformers used “the typical American style textbook (which) relies so heavily on a particular intellectual tradition, the neoclassical model, leaving out other traditions” (Stiglitz 1999, pp. 3-4). Certainly, when theoreticians criticize practical politicians, different authors blame the latter for their sins, although their conclusions are the same. For example, Stiglitz reproaches the less-appreciated Hayek, whereas many Russian critics consider the fascination with Hayek to be the reason for Russian reformers’ failures.

A naïve belief in economic advice and advisors’ superpower is also rather strange. We are not discussing the issue of who (among Western advisors as they are called in the West) has ever been involved at least in actual economic and political decisions. There were many self-proclaimed “advisors” to the Russian Government or the President who just once met one of many deputy ministers (there have been many more deputy ministers in Russia than, say, in Great Britain or in the USA).

More important, the role of an economic advisor never includes and should not include political decisions. Decision-making is the responsibility of politicians and administrators. An advisor should analyze the situation from a theoretical and historical point of view that includes his/her own experience. Another question is how good or bad such an arrangement is. It is both fair and appropriate that a politician or public servant (who is responsible before the voters or bosses) takes political decisions.

An economic advisor is simultaneously weak and strong because of a limited sphere of his/her professional knowledge. A politician when making a decision possesses a greater number of facts, including a real balance of social forces, interest groups, and concrete (often short-lived) political objectives, and thus cannot rely just only on theoretical and historic concepts. If an economist does not appreciate an advisor's profile, it can lead to conflicts and misunderstandings based on: "If I am an advisor, why doesn't this stupid politician follow my wise recommendations?"

Politicians accept recommendations from advisors in two cases. On the one hand, if their recommendations are obvious; for example, the necessity for budget equilibrium, price liberalization, fighting hyperinflation. Of course, sometimes there are recommendations not to balance budget, not to stop inflation, etc. However, the latter deal more with a sphere of pseudoscientific exotics. Anyone who remembers empty stores in the fall of 1991 and a real threat of hunger in Russian cities, understands why the prices were liberalized without any drawn-out discussions.

On the other hand, politicians will accept recommendations that correlate with a developing balance of political and economic forces. "Politics is an art to find what is possible to do". It is the main rule of a politician which influences his/her possibilities (even abilities) to accept these or those recommendations.

These two factors determine the choice of advisors by politicians. During the last decade, there have been many advisors in Moscow. Those advisors proposed various recommendations how to save the country, and their recommendations often radically contradicted each other. (Even the above-mentioned Paul Fischer with his idea to attract investments instead of macroeconomic stability is characterized as "an independent economist who has worked on technical assistance programs to Russia" (see *Transition*, 1999:6, p. 34).

Anyone who has somehow dealt with practical development and implementation of an economic policy is well aware of this fact, a fact true even for stable democracies. Stiglitz himself once noted this when he became the chief economic advisor to the President of the United States²⁶. These processes are even more complicated in a transition economy that lacks institutional stability, as well as a consensus on basic social values. That is why only a Western professor, who lives in stable democratic society may discuss the political and social struggle around the Russian (and in general post-communist) reforms as a struggle of metaphors and aphorisms taken from the books of other equally respected Western professors. While appreciating a beauty and witness of metaphors like "knowing what you are doing", or "knowing that you don't know what you are doing", "jump across the chasm in one leap" or "repairing the ship at sea", etc., we would hardly be able to analyze a post-communist economy while remaining captured by their beauty (Stiglitz 1999, p. 21-23).

The same must be noted regarding the programs of international financial institutions (particularly the IMF programs). The criticism of our Western colleagues is contradictory: on the one hand, projects agreed upon with the IMF are not realized or are poorly realized; on the other hand, the same projects are considered mistaken. There are again two approaches to the same problem: a general economic one, and a technical economic one.

The former view deals with the “Washington consensus” concept which is criticized for the lack of attention to institutional aspects of transition. One should take into account that institutional reforms take decades, and there is an immediate need to balance market and the budget and to stabilize currency. Therefore, it is practically impossible to synchronize these two aspects. It is possible only from a theoretical point of view. Very few real politicians (except for dictators) are able to undertake institutional reforms during a severe financial crisis.

The arguments regarding the role of foreign advisors can also be applied to the more technical issues related to governmental agreements with the IMF and the World Bank. But there is one additional circumstance rarely taken into an account. A good part of “the IMF conditions” were developed in Moscow, not in Washington. Russian politicians are the ones who initiated many of these conditions. And only then were they “imposed from the outside”. This is a typical way for a weak government to launch unpopular reforms.

Similar arguments can be applied to the “ideological prejudice” of the reformers. In order to implement ideology there should be corresponding social forces (groups of interests) which are ready to support this ideology. A politician’s decision per se is significant for stable societies with a sufficient inertial capacity. Post-communist Russia exhibited a highly turbulent social-economic structure plagued by the weak role of both private and state institutions. The ideological priorities of reformers are not as clear as they initially seemed. They have chosen the liberal strategy of transformation, but the development characteristic of economic systems in the end of the 20th century predetermined their choice to a great extent. Practical steps taken by the reformers make the arguments of “ideological prejudice” even less coherent. As it is seen through the privatization program, the voucher mechanism did not correlate with the reformers’ theoretical views, but it was in line with the logic of crisis. The same is true for a great number of other government decisions during the 90s.

Now, a few words about the cultural, historic, and geographical peculiarities of the country. Everything can be explained with this argument. For instance, the necessity to set up the Russian Bank of Development was explained by the size of the country and the existence of 10 time zones(?!); the existence of non-payments and barter transactions was also reasoned with the country’s huge territory; the multiplicity of currency rates was caused by the peculiarities of national character. The list is endless. My political experience proves that reference to a country’s national-historical-cultural-etc peculiarities is used at best when there are no other arguments to explain a problem, or – at worst, when one wants to steal something.

National and cultural peculiarities cannot be quantified. The same historic arguments can prove thesis and antithesis: that Russia is the most individualistic or the most collectivist country, that liberalism is as strange to its history as it fits the country, and so on. It sometimes seems that the “national-cultural-historic-etc.” explanation plays the role of the *deus ex machina* of Greek tragedies: it appears when there are no other arguments. This is true not only for Russia. For 15 years after World War II, researchers accepted Japan’s economic policy with great skepticism because of Japanese traditions and national character. Later, the same arguments were used to explain “the Japanese economic miracle.”

Nevertheless, there is one important factor connected with the country’s peculiarities. This is a level of economic development measured as GNP per capita. We have already stressed this factor while comparing reforms in Russia and China. However, its implications are much greater. When comparing countries, it is important to take this factor into consideration. Many

national differences which seem painful become much softer (or even disappear) if compared with the situation of the same countries during different stages of history, when their economic development level and social-economic circumstances are comparable.

At last, if the problem rests with the wrong textbooks, advisors, and ideology, why have all Russian governments during the 1990's pursued the same policy with similar basic elements? These governments were different both politically and intellectually. Their understanding of the country's historic experience and traditions was dramatically different. "Monetarist" Gaidar was replaced by a "strict administrator" Chernomyrdin who was the great hope of all the lobbyists and communists. But, he continued (though, inconsistently) the policy to stabilize a macro-economic situation²⁷, and a voucher privatization was implemented. The same direction was taken by a "young reformer" Kirienko. "Heavyweight" Primakov brought a lot of hope to the left wing. Their representatives played a great role in his government which was also supported by a left-nationalist majority of the State Duma. Nevertheless, Primakov also chose a policy of tough macro-economic stabilization. Stepashin and Putin chose the same path. Why did they all follow the same path? I believe there are "natural" factors that made all these prime ministers pursue the same direction, though with some variations.

* * *

The characteristic feature of all of these criticisms is their attention to theoretical models at the expense of practical ones. Not only has the approach been too abstract, there has also been a refusal to analyze concrete events. Most recommendations deal with a desirable policy, and not with practical issues and constraints. These recommendations portray a lack of deep knowledge of the Russian experience. This lack can be seen in the set of sources chosen by some ill-informed Western experts for their research: there is an excess of theoretical and sovietologist papers and a dearth of studies written by economists directly involved in implementing Russian reforms²⁸.

Discussion regarding the reasons of failures of market reforms has been reduced to a choice between the wrong set of reforms or a good set of reforms implemented in an inconsistent manner (Stiglitz 1999, p. 3). We believe, however, that the problem is much more complicated than that. Setting aside personal issues and agendas, one should be able to distinguish the policy being *implemented* (not just discussed).

In this case, our criticism related to historic, national and cultural peculiarities should not neglect some real specific features of the Russian reforms compared to other post-communist countries. Here, the path of reforms is more complicated with a lot of contradictions and conflicts relative to most of Central and Eastern European countries. We will discuss this further.

SECTION 2. Post-Communist Transformation in Russia as Special Case

“Why were the reformers so unwilling to start from where they were?”, Joseph Stiglitz asks (Stiglitz 1999, p. 24). He does not answer his question. (To be more accurate, he sees the reason as that the reformers *did not want* “to start from where they were”). But the problem has an opposite nature: the reformers had to start exactly from the place where they were — in the situation predetermined by circumstances in the fall of 1991, when the first Russian post-Communist Government was created.

1 A Weak State and the Revolution

The fundamental feature of Russian post-communist reforms is that they have been implementing in a situation of weak state power. Critics of Russian reforms often ignore this fact or view it as a result of the reformers’ deliberate activities. Instead, they view the Reformers’ liberal and anti-Communist ideology as the reason for the rapid liberalization and privatization that led to a state power crisis. The real process was quite different.

A radical (systemic) social transformation under a weak state power (government) is in essence the definition of revolution. This is a principle matter in the comparison of the modern Russian transformation with other post-communist countries. Russia is the only country (except for China) with a Communist system developed by itself, not imposed by outsiders. Consequently, the exit from Communism entails a much more complicated task that involves breaking a national consensus. This necessarily causes frictions between various social forces and interest groups. For Central and Eastern Europe overcoming the communist past and joining the European Society is an objective that unites their peoples. In the case of Russia, however, moving the country out of Communism and the demise of the empire are the sources of social tension and social disintegration²⁹.

A revolutionary transformation has its own logic and regularities, including economic ones (i.e., special features of an economic policy and dynamics of business processes)³⁰. An economic policy in a society torn apart by a social struggle can not be stable and consistent. First and foremost, the chaos is reflected in an inability of the state to influence social and economic processes. Revolution does not necessarily mean mass riots, but rather a systemic transformation under a weak state. This weakness ought to be incorporated into any discussion of modern Russian economic development. No researcher should ignore this fact.

The state’s weakness reflects itself in the volatility of economic policy and trends, in the multiple centers of power competing with each other, in the lack of sustainable and stable political institutions, and in the lack of any acceptable and consistent “rules of the game”. A state’s weakness also causes a number of specific economic problems. This fact has been consistently proven not only by the experiences of modern Russian, but also by the experiences of the great revolutions of the past³¹ (but this topic is largely beyond the frame of this paper).

Following is a list of some important economic consequences of a transformation under a weak government:

- An inability to collect taxes, which leads to an increased inflation tax and/or aggravates a budget crisis. As a result, the state is heavily under-financed, that means the government is unable to pay its bills. (We would like to underline that this was typical for almost all

countries in the same situation).

- Transaction costs increase rapidly. Accordingly, this decreases the competitiveness of domestic production.
- Demonetization of the national economy. (The same situation happened in countries where inflation of paper money was avoided because of metal coinage, but there cash was converted into treasury bills).
- The state's weakness makes an unavoidable impact on privatization by promoting sociopolitical (to stabilize the power) or fiscal objectives.

A weak state is extremely vulnerable to corruption and lobbyism. In Russia's case, it is impossible to strengthen state power by expanding the rights of the government to interfere in the economy. One often hears the following logic: the Russian state is corrupt, the Russian state is weak; one should empower the state. In other words, expand the power of a corrupt state. Of course, it is necessary to strengthen a government. However, such an objective should not just expand the government's ability to interfere in the economy, especially to allocate rare raw materials (material or financial) at its own discretion (naturally, "to the benefit of the nation" as any Russian '*dirigiste*' will tell you!).

These facts reveal the most important feature of a weak government approach to development and the implementation of economic policy. The quest for political majority through existing political institutions (parliament, parties) that are weak, poorly structured, and unstable is not as important as in stable counties. The key here is to guide the interaction between the representatives of power (the government) and the leading groups of economic interests. These leading groups have real political leverage and act as political parties in the early transformation stages³². Andrei Shleifer and Daniel Treisman are correct when they write that "reformers knew that any achievements of marketization would survive only if they were also able to create a powerful political coalition in support of free markets" (Shleifer and Treisman 1999, p. 1).

Again, we would like to stress that all the facts mentioned above *together* are characteristic for any full-scale revolution. Analyzing the modern Russian transformation from this viewpoint allows us to envision and explain a lot of strange things that happened during the last 10-15 years.

There is one complication specific to the Russian transformation: the interaction of three transformation processes instead of one. The first is a movement towards a market economy characteristic of all post-communist countries and China. The second is the crisis of a traditional economic industrial structure ("an economy of coal and steel") that needs to develop into a post-industrial society³³. The third is a revolutionary economic crisis, whereby a weak state power must implement a systematic restructuring. It is this interaction of circumstances that greatly hinders the Russian reforms.

2 The Beginning of the Post-Communist Reforms: Jacobins, Bolsheviks, and Contemporary Russia

Let us return to the issue Stiglitz raises at the beginning of this part of the article: his statement that Gorbachev started incremental reforms that were later destroyed by the radicals³⁴. This statement does not give an accurate depiction of events.

In reality, Gorbachev's reforms (*perestroika*) led to an economic imbalance because of their explicitly populist character from the very beginning. Some experts associate such populism with simultaneous democratization. Democratization made politicians greatly dependent on the population's attitude. However, this does not represent the whole truth: Gorbachev's most important objective was trying to move the economy. But after some serious economic problems surfaced, Gorbachev initiated his political reforms to neutralize his opponents within the Party elite.

There was a number of actions undertaken by the leadership of the USSR during the second half of the 1980s which launched the economic and political crisis. Among them: an attempt to increase radically investment growth at the time of a decrease of oil prices and, consequently, budget revenue; an anti-alcohol campaign that became a significant reason of the budget deficit growth; an authority given to the management of enterprises without an adequate system to hold them responsible for their economic activities; the start of spontaneous privatization (through leasing and cooperatives); an uncontrolled increase in monetary demand with a decreased supply of goods; radical liberalization of banking system; etc.

This type of economic policy development is characteristic for all large-scale revolutions. The so-called "governments of moderates," confident in their popularity and ability to use revolutionary enthusiasm for their own goals, are prone to exotic economic decisions. The later usually aggravates an economic crisis, which then leads to further power destabilization. The main result of *perestroika*'s economic reform was a sharp economic crisis. The following list displays the main elements of such a crisis:

- a shortage of goods compared only with the military economy of the 1940's or the Stalinist experiments of 1929-1933;
- the beginning of an economic decline and the rapid growth of the population's nominal income;
- the rapid evasion of the taxes with a budget deficit approaching 30% of GDP;
- the dramatic growth of external debt;
- the disintegration of economic space of the country.

In the fall of 1991, the country was on the brink of widespread hunger that threatened to spread over the main industrial centers. *De facto*, the USSR ceased to exist in August of that year and left Russia without its own currency, stable state borders, Army, police, etc. With a huge shortage of goods and the threat of hunger, there were powerful separatist trends within Russia; its regional administrations wanted full control over "their" production. (For more details, see Gaidar 1996, p. 132-136).

There is a "so-called explanation" for the beginning of post-communist reforms in Russia: it came about as a result of bad decisions made by Boris Yeltsin and Yegor Gaidar in favor of "monetarism" and liberal market entry. However, everything that happened during 1991-1992 makes such an explanation unreasonable. Yeltsin can hardly be viewed as a chaotic liberal. In addition, the Russian cultural and historic traditions are not the most fertile ground for liberalism without serious political justification. In reality, without having real administrative tools, the Russian government was able to do only one thing: to choose a consistent path of liberalism³⁵. The liberalism of 1991-1992 was able to eradicate the hunger and cold of the winter, as well as mitigate the collapse of Russia³⁶. However, after the real danger had passed and administrative resources were restored, the great leadership majority rejected economic liberalism. (However, they applied it every time a crisis took place.)

This is the birth of post-communist radicalism. However, the radicalism itself is not a feature nor a product of the transformation revolution. As we mentioned before, the radicalism of the first post-communist stage is directly correlated with the depth of the macroeconomic imbalance; not the result of just one circumstance of political instability. A direct product of political instability would be a pragmatism and an ideological freedom to take action. The latter should be discussed separately. Stiglitz compared more than once the radical reforms in Russia with the activities of two famous revolutionary movements of the past: the Jacobin movement and the Bolshevik movement (Stiglitz 1999, p. 21-22). From our point of view, there are indeed solid reasons for such a comparison, although they are dramatically different from the ones suggested by the author of "Whither Reform?".

In reality, there is no practical evidence that rigorous and decisive actions undertaken by radical governments in the past were connected with their radical ideology, their desire to implement their objectives, and their wish to break with the Old Regime's ways within the shortest period of time. Without the usual commonsense stereotypes, various scientific (not publicist) studies illustrate quite a different picture. In their activities, the radical governments never stuck to their program. It were the early, "moderate revolutionary governments" (Brinton 1965) who tried to perform a "scientifically justified" restructuring with the best features of both the Old Regime's experience and a revolution aiming at "incremental, gradual and adaptive" changes. In practice, these measures undertaken by the weaker power aggravated the crisis. If incremental changes did not fuel such deep crisis, radical governments would never come to power. With power, radicals act pragmatically (even though they may have various slogans and ideological points asserting otherwise).

From a political point of view, radical governments defend their new system by reverting back to the old model. This is most important: Jacobin and Bolshevik economic policies served the same idea. That is why it was easy to review their programs. There are many reputable studies that back up such a conclusion³⁷.

Thus, if there is a "Jacobin" character in the first post-communist reforms in Russia, it differs from the one described by some writers. Such a "Jacobin" character does not imply an ideological commitment, the destruction of these old institutions, or an accelerated restructuring. It argues the necessity to concentrate all the forces and resources to stabilize a political situation in order to protect a new regime from serious political and economic threats. The first post-communist Russian government recognized this necessity. It fought "a threat to restore an old regime" with all the available means (without permitting the excesses of past revolutions). Therefore, it allowed a new political system to survive, sometimes sacrificing the consistency and volatility of economic direction. Because of the flexible and decisive nature of the first post-communist Russian government, some experts now have an opportunity to write about political dangers in the early 1990s that never *materialized*. (Stiglitz 1999, p. 3).

Gorbachev's "incremental" policy (which pleases Joseph Stiglitz) and a radical after-Gorbachev period are contradictory only on the surface. In reality, they are organically intertwined. The reasons are not just economic: when a large imbalance results in further painful measures to secure financial stabilization; there forms a deep historic connection between the experiments performed by "moderate revolutionary-reformers" and their revolutionary successors. This connection has been proven by past revolutions and has resurfaced in modern Russia.

The weakness of state power determines almost all the economic actions of governments. First and foremost, this concerns privatization.

3 Privatization with a weak state

Stiglitz and many other critics strongly consider voucher privatization to be the main factor weakening the country and setting in motion the other failures of the Russian economy and policy. As we have seen, at the beginning of the privatization, state power was dramatically weakened and was unable to influence the most important public processes in the country. We would like to demonstrate how the state's weakness made an impact on privatization mechanisms and manifestations.

In general, there are three main issues to be addressed in connection with privatization: economic, fiscal, and sociopolitical.

The economic objective of privatization deals with the creation of an owner. The Soviet government of the 1980-1990s declared the same objective. That government was simply afraid to name it "privatization." Therefore, it called the process "de-etatization". (The Soviet government was fascinated with the success of British conservatives headed by Margaret Thatcher.) However, production was declining and the country was entering an economic crisis. It was clear that new decisions needed to be made. Consequently, the logic to democratize the country and to reorient it towards western values led to acknowledging private property as a prerequisite for positive economic progress.

The deep fiscal crisis that began in the second half of the 1980s sparked an interest to privatize as a means to increase the budget and decrease the "monetary overhang" that results from the huge money supply brought to the market at the time. In reality, it was impossible to use privatization to solve the country's financial problems because for a long time there was inadequate capital.

In addition, the country's leaders wanted to utilize privatization as an instrument to strengthen their political status and create a coalition for this or that economic direction. This last factor became critical at the beginning of the 1990s, when the post-communist reforms entered their crucial stage, and the conflict between new communists and the market democracy led to a number of unconstitutional excesses (1991 and 1993). Property issues were treated as powerful arguments to unite political forces and groups of economic interests.

The events in Russia related to property restructuring have occurred during revolutions in other parts of the world (i.e., the British revolution of the mid-17th century, and the French revolution at the end of the 18th century). Property manipulation is an important feature of weak state power. Naturally, property transactions facilitated decisions in the three areas mentioned above (economic, fiscal, and sociopolitical). However, in the short-term, they often contradict each other. As a rule, the sociopolitical area takes the first place followed by the fiscal area (as power is stabilized), with the economic one coming at the end³⁸.

During the last 15 years, the objectives of privatization have gradually changed. These changes are reflected in various forms which have been declared during the same period of time. The word "privatization" has been used with attributes corresponding to the change taking place at each given time — "directors", "people's", and "monetary".

The enterprise reform of 1987-1988 was intended to privatize in favor of directors. In fact, the management of enterprises was free from the control of economic authorities. They were not dependent on an owner who did not exist. This move by Gorbachev's administration represented one of the key revolutionary features. It was an attempt to expand the social base of reformers attracting directorship and labor collectives with their new right to elect directors (Gaidar 1995, p. 149-151; Aslund 1995, p. 225-226). At the same time, it destabilized the administrative and institutional structures because a new powerful economic group was free of both administrative and market limitations.

In practice, all the normative documents regulating privatization in the Russian Federation³⁹ include these three areas. However, there are significant differences between the documents adopted at different stages of the economic reform. Thus, the first (late Soviet) privatization documents of the Russian Federation paid more attention to political and fiscal objectives⁴⁰. While favoring the directorship and providing labor collectives with various benefits, the Russian government strengthened its own social base in order to balance the Soviet power. Those measures were supposed to enhance the Russian government's political status both directly and indirectly (by facilitating the reporting of enterprises to the Russian Federation instead of to the Soviet Union). We would like to underline that all of these measures were taken at the moderate Soviet stage of the reforms.

The first post-communist privatization documents had the following privatization objectives: "to facilitate general political and economic stabilization objectives," "to increase the productivity of enterprises' activities by transferring them into the hands of the most efficient owners," "to increase budget income."⁴¹ We need to point out, at this juncture, that there were no sociopolitical objectives for privatization; naturally, the first Government of independent Russia committed to economic liberalization expected social consequences to follow from privatization. One of their main objectives was to form a class of private owners. However, they treated such an objective as strategic and did not utilize it as leverage in the battle to strengthen the new regime's political status. They changed their approach later, during the second half of 1992. Initially, the Government tended to pursue the expansion of various interest groups. However, their main objective was to reach a macroeconomic stabilization and overcome a fiscal crisis in the shortest period of time. The search for non-inflated sources to finance the huge state expenditures characteristic of post-socialism fostered the idea of utilizing privatization proceeds to fuel the budget.

However, real events developed in another direction because the key sociopolitical issues were consolidated, and there was no strong state power either. By the middle of 1992, the stabilization policy faced powerful opposition. The representatives of almost all the industries and sectors of the domestic economy united to ask for financing from the Government. Such pressure made the Government pull back from stabilization, an action that caused an inflation outbreak in the fall of 1992. At the same time, the Government undertook the necessary measures to create a sociopolitical coalition for its support. In this regard, privatization became a key factor in the consolidation of sociopolitical backing.

The sociopolitical objectives of privatization could be implemented in two ways. First, attracting representatives of the directorship capable of managing their enterprises efficiently in spite of demand limitations and market competition, and who were eager for legal property guarantees for their enterprises. Second, by making redistribution attractive to the population. This was the target of the mass voucher privatization model.

By the summer of 1992, the approach to privatization dramatically changed. A fiscal objective became less important because the stabilization in Russia was explicitly postponed, and inflation became a stable feature that softened the budget income problem. Because of spiraling high inflation, much less attention was paid to the creation of an efficient owner. The sociopolitical objective of privatization became the dominant one. Both versions of the State Privatization Program, from June 11, 1992, and from December 24, 1993, in particular, demonstrate this fact⁴². Both documents stressed the importance of "creating a deep layer of private owners as an economic base for market relations" (Privatizatsiya, 1993, p. 70). However, in the short-term, a voucher privatization mechanism aimed at different objectives: at both strengthening the role of a directorship and promoting a "people's" privatization, a move-

ment that would involve the country's entire population in a property redistribution process. In addition, the urban population privatized their apartments almost free of charge, and the rural population privatized their land plots.

Due to the governmental efforts of 1992-1994, all the sociopolitical objectives were more or less implemented. In 1993, the directorship was about to be divided into supporters or opponents of the market reforms: those who became competitive in the market, and those who needed the government to provide constant financial support and protection in the international economic sphere. In fact, the majority of the population felt misled and declared its frustration during the parliamentary elections of 1993 and 1995. Nevertheless, the key elections of 1996 (presidential) showed that the population nevertheless opted for the reforms.

The voucher mechanism was not efficient. The reformers themselves admitted this fact. However, it was a populist thrust that fostered power in the short run. The voucher period facilitated the creation of new owners interested in a stable new Russian economy. It created an anti-Communist and anti-inflation coalition to achieve the first macroeconomic and political stabilization objectives.

By the middle of the 1990's, with a strong new government in place, and the budget crisis increasing, the privatization approach was shifted towards fiscal objectives. The Government was left without an inflation tax, so it needed privatization proceeds. Such a change destabilized the previous coalition, which expected the Government to continue its role of "strategic partner." The Government, however, was strong enough to stand up to the interest groups aggravating the political struggle of 1997-1998.

Due to length constraints, we are not going to discuss the various privatization models of past revolutions. It is enough to say that they are surprisingly similar to modern Russian models⁴³. In fact, the following is the list of characteristic features of property redistribution during a revolution.

First, the financial impact from property redistribution is always much less than expected. Sometimes, the assessments are incorrect; they can be based on old redistributed assets. The real cost is much lower because of political instability, a great volume of the property to be redistributed, and the necessity to expedite reforms for political purposes.

Secondly, most of the property appeared to be in the hands of intermediaries and was utilized in multiple sales. This happens because of political instability and the speed of the redistribution process. It takes an additional and sometimes rather a long period to further redistribute property in favor of an efficient owner.

Third, as proven by past revolutions, a significant part of the property is left in the hands of the established political and economic elite who have ways to pay off the new power. This is especially true for revolutions with a political component dominating a social one.

However, all these processes consolidate a political power and strengthen a new elite. This very target should be treated as dominant in the process of a revolutionary transformation of the property.

In Russia, privatization, even in its extreme forms (vouchers, collateral auctions, etc.) strengthened, not weakened this power. Of course, one can say that the power was bad and inefficient. However, this issue deals with pure politics and individual preferences. From a political-economic point of view, the Russian privatization should be viewed as mostly a social process that implemented not an abstract ideal model, but the results of a real political struggle between various groups of interests; some of who initially had more resources than the state itself.

In this article, we have reviewed a number of the widespread arguments by western critics regarding the Russian reforms. These discussions should not be interpreted as an attempt to justify what has been done in Russia nor as a claim that there were no mistakes in the policies of the last decade. We simply wanted to illustrate that the process of Russian restructuring is a much more complicated phenomenon than it appears from an external glance.

Similarly, these discussions should not diminish a purely theoretical interest in the works written by strict critics of the Russian reforms, as well as for works written by experts with positive attitudes toward the Russian experience⁴⁴. However, it should be clear that most of our arguments are based on articles in which western economists disagree with each other about *what is going on in Russia*, and how it correlates with *their* theoretical models.

Bibliography

Abalkin, L.I., Bogomolov, O.T., Makarov, V.L. et al: "Novaya ekonomicheskaya politika dlya Rossii: sovместnoe zayavlenie rossiiskikh i amerikanskikh ekonomistov". Nezavisimaya gazeta 1.7.1996.

Aftalion F.: The French Revolution: An Economic Interpretation. Cambridge: Cambridge University Press 1990.

Ashley M.: Financial and Commercial Policy under the Cromwellian Protectorate. London 1962.

Aslund A.: How Russia Became a Market Economy. Washington D.C.: The Brookings Institution 1995.

Aslund A.: "Russia on the mend". Chase International Fixed Income Research Highlights of Current Strategy. 7.9.1999.

Aven, P.: "Ekonomika torga". Nezavisimaya gazeta 27.1.1999.

Brinton C.: The Anatomy of Revolution. Revised and Expanded Edition. New York: Vintage Books 1965.

Brovkin, Vladimir: "Wishful Thinking about Russia". Transition 1999:6, pp. 22-25.

Ekonomicheskaya politika Pravitelstvo Rossii. Moskva: Respublika 1992.

Ellerman, D.: "Vauchernaya privatizatsiya kak instrument kholodnoi voiny". Voprosy ekonomiki 1999:8, pp. 99-111.

Fukuyama F.: The End of History and the Last Man. London: Penguin Books 1992.

Gaidar, Ye.: Gosudarstvo i evolyutsiya. Moskva: Yevraziya 1995.

Gaidar, Ye.: Dni porazhenii i pobed. Moskva: Vagrius 1996.

Gaidar, Ye.: "'Detskie bolezni' postsozializma". Voprosy ekonomiki 1997:4, pp. 4-25.

Gaidar, Ye., ed.: Ekonomika perekhodnogo perioda: ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii (1991-1998). Moskva: IEPPP 1998.

Goldstone J.A.: Revolution and Rebellion in the Early Modern World. Berkeley, CA: University of California Press 1991.

Kots, D. with F. Weir.: Revolution from Above: The Demise of the Soviet System. London and New York: Routledge 1997.

Illarionov, A.: "Sekret kitaiskogo ekonomicheskogo chuda". Voprosy ekonomiki 1998: 4, pp. 14-26.

Intriligator, M.: "Shokiruyushchii proval 'shokovoi terapii'". In O.T. Bogomolov, ed.: Reformi glazami amerikanskikh i rossiiskikh uchenikh. Moskva: REZh 1996.

Mau, V.A.: Ekonomika i vlast. Moskva: Delo 1995.

Mau, V.A.: Ekonomicheskaya reforma: skvoz prizmu konstitucii i politiki. Moskva: Ad Marginem 1999.

Mau, V. and I. Starodubrovskaya: "Ekonomicheskie zakonomernosti revolyutsionnogo processa". Voprosy ekonomiki 1998:4, 39-57.

Mau, V. and I. Srarodubrovskaya: "Economic Regularities of the Revolutionary Process". Social Sciences 1999:1.

McFaul M.: "1789, 1917 can guide '90s Soviets". San Jose Mercury News 19.8.1990

McFaul M.: "Revolutionary Transformations in Comparative Perspective: Defining a Post-Communist Research Agenda". In Revolutions. Reader. Stanford: Stanford University 1997.

"Milestones of Transition". Transition 1999:6, pp. 15.

Morita T.: "Pretence of Market Economy and Legacy of Old Regime – Political Economy of System Transformation". Transition 1999:6, pp. 17-18.

Privatizaciya v Rossii: sbornik normativnykh dokumentov i materialov. Chast 1. Moskva: Yuridicheskaya literatura 1993.

Radygin, A.:D.: Reforma sobstvennosti v Rossii: na puti iz proshlogo v budushchee. Moskva: Respublika 1994.

Radygin, A.: Privatisation in Russia: Hard Choices, First Results, New Targets. London: CRCE 1996.

Rose, R.: "Distrusting Government Institutions, Russians Develop Survival Strategies". Transition 1999:6, pp. 9-10.

Rosser, J.B. and M.V. Rosser: "Schumpeterian Evolutionary Dynamics and the Collapse of Soviet-Bloc Socialism". Review of Political Economy 1997:2.

Sachs, J.: "The Transition at Mid Decade". American Economic Review Papers and Proceedings 1996: pp.128-133.

Sachs, J.: "Neudacha rossiiskikh reform". Nezavisimaya gazeta 16.9.1999.

Shleifer A., and D. Treisman: Without a Map: Political Tactics and Economic Reform in Russia. Manuscript, 1999.

Sinelnikov, S.: Byuzetnyi krisiz v Rossii: 1985-1995. Moskva: Evraziya 1995.

"Situation of Russia's Poor Aggravates". Transition 1999:6, pp. 4-7.

Stiglitz, J.: "Mnogo-obraznee instrumenty, shire celi: Dvizhenie k post-washingtonskomu konsensusu". Voprosy ekonomiki 1998:8, pp. 4-34.

Stiglitz J.: "Whither Reform? Ten Years of Transition". Washington, DC: The World Bank 1999.

Williamson J.: Latin American Adjustment: How Much Has Happened? Washington, DC: Institute for International Economics 1990.

Williamson J.: "In Search of a Manual for Technopols". In J. Williamson (ed.): The Political Economy of Policy Reform. Washington, DC: Institute for International Economics, 1994, pp. 525-596.

The World Bank: Russian Economic Reform: Crossing the Threshold of Structural Change. Washington: The World Bank 1992.

Wolfensohn, J. D.: "Interview: The New Development Approach and the Transition Economies". Transition 1999:6, pp. 1-4.

Notes

¹ Stiglitz (1999). The Russian translation of this article appeared almost simultaneously in *Voprosy ekonomiki* 1999:7.

² The June 1999 issue of the Transition Newsletter (published by the World Bank in collaboration with The William Davidson Institute) is the most vivid example of this kind. In particular, see Brovkin (1999), "Milestones" (1999), Morita (1999), Rose (1999), "Situation" (1999). Here, you can find the most vivid example of the impact which fashion and common wisdom make on the most responsible and "politically correct" (as they seem) representatives of the international economic community. World Bank President James Wolfensohn (1999), whose self-assessment as a Russian privatization expert is highly unlikely, provides the following example in a rather streamlined manner: "privatization prior to establishing an effective regulatory or competition framework can be a recipe for a disaster, as it has been proven in Russia". In the given case, we do not discuss the justification of such a conclusion (we will return to it later), we just want to highlight its "going without saying" nature, an undoubted character of the conclusion presented by the president of the World Bank.

³ We do not include into our analysis works standing outside economics as a science and scientific ethics. Unfortunately, they do exist. A typical example of this kind is Ellerman (1999).

⁴ One of the first among famous western economist (putting aside the so-called "sovietologists") who advocate the application of the Chinese experience to Russia was Michael Intriligator (1996), and later, a corresponding system of arguments was presented in a mutual report of a number of famous economists of Russia and the USA. (Abalkin and others, 1996).

⁵ In a Soviet history, the movement towards gradual industrialization, through the development of private farms, light and food industries was connected with the name of Nikolai Bukharin, who proclaimed the slogan "Get yourself richer!" (To be more accurate, he used the slogan of Guizot 100 years before). The industrialization model proposed by Bukharin was stigmatized by Stalin as a "right incline", and its advocates paid with their lives. During the following decades, a Bukharin model's viability and its compatibility with a Communist totalitarian state had been an issue of various theoretical discussions. China showed that the model was a real and practical alternative. In fact, it should be mentioned that we are talking about a principal *economic* possibility for the development of this kind, not about its *political* implementation in the Soviet terms of the 1920's and 1930's.

⁶ In more details the interaction between political and economic factors of Gorbachev's reforms and post-communist Russia see Gaidar (1998), chapters 1-3.

⁷ It should be said that the most consistent (though, consistent not in socialism, but in liberalism) economists stick to the very same idea taking a level of a budget burden on GNP as an explanation of the reasons for such a drastic difference in a growth rate between a Communist China and post-Communist Russia. (Illarionov 1998; Aven 1999).

⁸ It should be said that Gorbachev was very much aware of this. The author of this paper once asked him why neither he nor his colleagues had ever tried to follow a Chinese way. The President of the USSR got surprised and answered that everyone had already realized the principal differences between the situations in the USSR and China.

⁹ Even with their moral imperfection, all the regrets that political reforms were started together with economic (and sometimes before), are very popular among western experts (especially, from a left side). In this connection, the author would like to remember his discussion with a famous Italian economist, an expert on the USSR

and Russia. Answering the traditional reasoning for the mistakes made by Gorbachev on his movement towards political reforms, I noticed: “You may be right. However, you have to admit that the mistakes of this kind have already been made in history. For Italy it would have been much better if Mussolini had not involved the country into World War II, but had ruled instead till the middle of the 1970’s. The Italian economy would have been developing with a great sustainability, there would not have been all the governmental games, there would not have been the terror of “red brigades”, corruption, Northern separatism and other sharpest problems of the postwar decades”. My counterpart was deeply shocked with such a comparison, though it was completely natural and sufficiently explicit.

¹⁰ Paul Fischer who introduces himself as a western advisor has brought this thought to absurdity when writing: “Russia must focus on enticing investors rather than... balancing its budget” (Transition, 1999:6, 34).

¹¹ In this conjunction, it is appropriate to mention the following extract from Stiglitz: “I have no great quarrel with “shock therapy” as a measure to quickly reset expectations say in anti-inflationary program. The controversy was more about the attempted use of a shock therapy approach to install institutions – where it might more aptly be called a “blitzkrieg” approach” (Stiglitz 1999, p.21).

¹² Sometimes it has lead to pretty funny and sad things at the same time. Gaidar and his colleagues were blamed for a decline of a demographic situation in Russia three months after they had joined the Government and one month after they had started liberalization. As we can see, from the very beginning their critics believed in the supernatural power of the Reformers.

¹³ To the point, Polish reformers had a big advantage comparing to Russian ones. As known, the last Communist government head by Rakovsky refused to regulate prices on many groups of goods by the state. It was that decision which transformed a hidden and suppressed inflation into its open form. The first post-communist government led by Tadeusz Mazowiecki and Leszek Balcerowicz needed only to finish the liberalization and implement stabilization measures. In Russia, Gaidar had to deal with the range of challenges, dealing with both liberalization and stabilization.

¹⁴ Sometimes, there is an impression that an expression, “shock therapy”, is more often used to describe unsuccessful cases of stabilization policy, than in its initial genuine meaning. In this regard, again, a shock therapy in Russia is, in fact, bad. But, it is bad because it was inconsistent and uncompleted. In contrast, the standard blames for a vicious nature of such a policy have almost never been addressed to Estonia, Latvia, Lithuania where the stabilization measures were not easier than in Russia from a social point of view. Western critics sometimes seem reluctant to use this expression in the connection with Poland: the Polish experience poorly fits the range of standard blames addressed to a “shock therapy”.

¹⁵ Here, we are again dealing with a selective criticism of stabilization policy. As for real exchange rate appreciation, the situation in Russia was not too different from the situation in Estonia whose kroon was much closer connected with a Deutsche Mark than the ruble with the dollar. However, our critics much harder blame the Russian policy considering it to be the reason for institutional disasters. Though, a simple comparison of the experience of different countries similar in this regard makes oneself to think that there should be other reasons for practical results to be so different from each other.

¹⁶ We are putting aside the discussion on a *real* overvaluation of the ruble in 1997. There is no agreed opinion among economists on this.

¹⁷ The program “500 days” created by Yavlinsky and Shatalin was written within this logic. Yavlinsky, the leader of “Yabloko” has also later insisted on a given sequence of reforms to be implemented.

¹⁸ For a full economic analysis of Russian privatization, one should refer to papers by A. Radygin (see Radygin (1994), Radygin (1996), as well as chapters 12 and 13 in Gaidar (1998)).

¹⁹ We would like to mention just one quotation belonging to Dmitry Vasilyev, who was one of the founders and ideologists of a voucher privatization: "At the beginning, our views of the privatization (Chubais's, mine and a majority of our advisors) were significantly different from the ideas put in a model realized in a practice". (Radygin 1994, p. 10). We need to notice that it was written before a voucher privatization would have been completed. The author should not be blamed that he changed his view under the influence of later experience or criticism from his political opponents.

²⁰ In a greater detail, the transition from privatization personal accounts (named checks) to a voucher of 1992 type is discussed in Radygin (1994), pp. 78-83.

²¹ This term was invented later. See Radygin (1994), pp. 46-53 for greater details.

²² Sometimes, the situation acquired the funniest shapes. The leadership of the USSR was fascinated with cooperatives which they regarded as the implementation of Lenin's theory (there is a famous article "About the Cooperation" written by him). They adopted a special recommendation to create cooperatives at state enterprises. When they thought again, it was too late.

²³ We do not discuss here the fairness of such a privatization mechanism which means that those "closer" to better assets are in a more favorable and advanced situation. Nevertheless, such an argument is rather important, because we are not talking about a one-piece privatization. We are talking about the reallocation of property in the country whose population has been deprived of it.

²⁴ There is also another position which says that international financial institutions did not provide Russian reformers with their assistance in time when the Russian reformers still had a political capital to undertake deep market reforms. (Sachs (1996) pp. 128-133; Sachs (1999), Aslund (1999)). It is not within the framework of the this paper to discuss this issue.

²⁵ It shows a lot when Stiglitz refers to a paper of Martin Weitzman, "who, unlike the most prominent Western advisors, was a scholar of Soviet-style economies", that is why "gave the pragmatic argument..." (Stiglitz 1999, p. 14n). With the same foundation, one could quote Stalin who possessed a colossal experience in this area.

²⁶ In one of his interviews Stiglitz noticed that up to the recent time they had listened to the recommendations of economic advisors just partially. The main duty of the advisors was to help presidents' children or grandchildren to do their homework in school economics.

²⁷ Not long before his resignation, at the beginning of 1998, Chernomyrdin even spoke about the victory of "our correct monetary policy" during an open meeting of the Government.

²⁸ It is even more strange because of the involvement of "writing economists" in a practical policy which became a special feature of the post-communist reforms. In a more "normal" development of events, such a high involvement would be characteristic for only professional politicians and administrators. John Williamson (1994) was one of the first who paid their attention to this fact. He was also one of the first who used the term "Washington consensus" (see Williamson (1990)). Naturally, one can suspect economists-participants of the reforms to be "predetermined in their opinions" (though it needs to be proved). However, it is highly unjustified and unfair not to mention their papers at all.

²⁹ Here, we do not discuss a detailed argument related to the revolutionary character of the Russian transformation. For more details, see Mau and Starodubrovskaya (1999) and the introduction of Gaidar (1998). There is also a justification and characteristics for “a revolutionary economic crisis” phenomenon. Among western researchers, McFaul (1990; 1997) and Goldstone (1991) should be mentioned separately.

³⁰ Brinton (1965) discusses the issues of revolution regularities in more detail.

³¹ For example, see Ashley (1962), Aflation (1990) and Mau and Starodubrovskaya (1998).

³² For more details about the role of economic agents, see Mau (1995), pp. 45-46. In their last work Shleifer and Treisman paid special attention to the importance of another political-economic model which considers the domination of interest groups over state institutions. They write: “In a fluid political setting, where the implementation of policies is as important and as difficult as their enactment, and where enactment relies on agreement between powerful political groups rather than a vote, elections are, at most, one of many arenas in which interest groups compete” (Shleifer and Treisman 1999, p.6).

³³ For more details on the crisis of a traditional industrial society as an explanation for the Russian transformation see Rosser and Rosser (1997).

³⁴ “The Gorbachev-era perestroika reforms furnish a good example of incremental institutional reforms” (Stiglitz (1999), p.24). The same is argued by Kots with Weir (1997). Their whole book discusses social-political reasons which led the USSR out of the frames of the “good” Gorbachev reforms.

³⁵ It also corresponded with a cultural and intellectual renaissance of liberalism characteristic for the world at that time. Fukuyama (1992) became a symbol of that time.

³⁶ Now, after some time, there is an argument that all these dangers were hyperbolized, and would not have materialized. However, at that time not only politician but the population as well took those danger very seriously. There are more arguments to prove that those dangers were not materialized because of timely measures undertaken by the reformers.

³⁷ We would like to discuss just two examples. Initially, the Jakobin revolutionaries famous for their Maximist policy were against such actions. After their victory, the Bolsheviks undertook a particular land program, and later rejected it. The same happened with various national ideas adopted or rejected because of the war situations. Bolsheviks “abandoned the money” when their military opponents (Kolchak’s Army) overtook the country’s golden stock.

³⁸ We would like to remind that we are talking about the privatization with a weak state. Privatization undertaken by a stable government has a different logic. For example, the British privatization of the 1980’s was able to address all three areas.

³⁹ About Property in the USSR, The Law of the USSR of March 6, 1990; About Enterprises in the USSR: The Law of the USSR of June 4, 1990; About Property in Russia: the Law of Russia of December 24, 1990; About the Privatization of State and Municipal Enterprises: the Law of the Russian Federation of June 3, 1991; The Main Principles of the Program for the Privatization of State and Municipal Enterprises in the Russian Federation for 1991: Adopted by the Decree of the President of the Russian Federation of December 29, 1991; The State Program of Privatization for State and Municipal Enterprises in the Russian Federation for 1992: Adopted by the

Resolution of the Supreme Council of the Russian Federation of June 11, 1992; the State Privatization Program for State and Municipal Enterprises of the Russian Federation: Approved by the Decree of the President of the Russian Federation of December 24, 1993. These and other early decrees are collected in *Privatizatsiya* (1993).

⁴⁰ For example, see the laws of the Russian Federation “About Property in Russia” of December 24, 1990, and “About the Privatization of State and Municipal Enterprises” (of June 3, 1991).

⁴¹ “The Main Principles of the Privatization Program for State and Municipal Enterprises in the Russian Federation for 1992”, approved on December 29, 1991. (*Ekonomicheskaya* (1992), pp. 28-29).

⁴² It should not be considered as an unusual development. It fully correlates with the development of a revolution at its radical stage. For example, French Jakobins had to prefer fiscal efficiency over tempo when making their decision on a land distribution.

⁴³ Mau and Starodubrovskaya (1998) discussed the correlation of Russian privatization and experiences of property restructuring during the past revolutions in detail. The most interesting experience is that of the English revolution of 1650 with various forms of property redistribution. First, the royal land was sold, its greater part later appeared in the hand of the Parliament, generals of the Revolution Army and of City businessmen who financed the Parliament members and generals. Second, royal aristocracy’s land was also for sale. It was usual for the previous owners to repurchase their land (via third parties, and sometimes directly). It was a very important transaction, from a social-economic point of view: the treasury received additional funds, and the property was freed of old feudal limitations. The English revolution showed that the change of property form should not be identified with the change of its owner. Furthermore, from a strategic point of view, the form is much more important.

At last, thirdly, the redistribution of Irish land was performed with a mechanism similar to vouchers. The Government did not have funds to pay to their soldiers. That is why it issued securities: certificates for Irish land ownership after an Irish revolt to be suppressed. These certificates were used to pay the Army. The soldiers immediately sold a greater part of their certificates with a great discount. For a very long time, the regime’s critics blamed the government that the land appeared to be not in the hand of ordinary citizens, but in a fist of intermediaries. However, the revolt was suppressed, and property redistributed.

⁴⁴ Shleifer and Treisman (1999) and Aslund (1999) can be listed among that type of works, very infrequent recently.