COMPARATIVE ECONOMIC STUDIES, XLIV, NO. 4 (WINTER 2002), 31-35

A Political Decision

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The paper by John Odling-Smee and Gonsalo Paster (2002) has provided new insights on the political dimensions of the IMF's stand on the ruble zone. These political issues are discussed in the general context of the early reforms in the former Soviet states and more specifically they are discussed in the context of the available options regarding maintenance or dismantling of the ruble area.

JEL Classification Numbers: E52, F33, F42, P24

Keywords: Monetary policy, ruble area, national currencies

In their provocative paper "The IMF and the Ruble Area, 1991-93", John Odling-Smee and Gonsalo Paster (2002) discuss the problems related to the introduction of national currencies in the post-Soviet zone. This is a key issue for understanding the development of the situation in Russia and other CIS states, and the Baltic states at the initial stage of reforms. The arguments laid out in the paper force me to make more concrete my own views on the role the IMF played in the development of the events regarding the Ruble area. Previously, I had related the Fund's stand to an inaccurate understanding of the technical aspects of the issue, however, the authors' arguments have convinced me that it was the Fund's political stance rather than the above-mentioned technicalities.

Before analyzing the paper, allow me first to comment on the general context and the available options regarding maintenance or dismantling of the Ruble area. Market reforms in the former Soviet states (especially in the CIS countries), were considerably more complicated than in Eastern Europe.

In Eastern Europe and the Baltic states, when the reforms were started, there were millions of people for whom markets and private property had been in childhood a normal part of everyday life, only later to be replaced by socialist influences. These people's children formed the backbone of the younger cohorts that were most active in politics and business. In the majority of cases, socialist institutions and establishments were imported on the back of Soviet bayonets, and as a result a considerable section of society in these countries

always perceived them as alien and forced upon them. Furthermore, in many Eastern European countries, there existed certain elements of civil society (a relatively independent church, small private businesses, etc.).

In contrast, there was nothing of the sort on the vast majority of the territory of the Soviet Union. The socialist experience was the only one available, and the majority of the population had a picture of market economies based entirely on a very few movies about life in the West, and the number of people who had ever visited countries with developed market economies was pitifully small. In these countries socialism was not forcibly imported from outside, but rather was a result of the tragic development of the country's history, and thus inseparable from it. For seven decades, any attempts by society at self-organization were much more brutally suppressed than in the majority of Eastern European countries. In addition, the economic structure of the Soviet economy to a greater extent was deformed by socialism and was much more militarized than the younger socialist economies of Eastern Europe.

Consensus within national political elites on the issue of choosing a country's strategic development path was the distinguishing feature of those countries which proved capable of achieving rapid disinflation and laying the foundations for reviving economic growth. Governments, despite frequent turnover in some cases, focused on accelerating integration with the European Union. This made it possible to put an unspoken veto on any large-scale experiments with populist economics. Populist rhetoric and proposals to resolve economic problems by means of major monetary emission and increasing budget expenditures were quite common during election campaigns. However, they proved to have very limited impact on economic policy. In contrast to this, there was no such consensus in the majority of former Soviet republics, or Bulgaria and Romania. In these countries, a bitter political battle was fought over the course of economic reform, and fiscal and monetary policies underwent sharp fluctuations.

The fundamental difference between the development of former Soviet republics and that of Eastern European countries was that the former suffered a simultaneous collapse of the socialist system and the state.[1] Eastern European countries, on the other hand, inherited from socialism functioning state institutions. Naturally, these institutions had to be re-fashioned in accordance with the new democratic and market conditions, however, the mere fact of their existence, unambiguous legislation, and the possibility of providing clear answers to such fundamental questions as to who controls borders, who has a monopoly on the legal use of force, who levies taxes, regulates the money supply, etc. — broadened the range of alternatives for implementation of post-socialist reforms and carrying out the transition to a market economy. By way of contrast, the largest CIS state — Russia — inherited from the Soviet Union a non-functioning constitution that failed to establish a strict separation of powers at the federal and regional levels, leading a crisis of *dvoyevlastye* or dual power. The resulting conflict between the executive and legislative branches hugely complicated policy-making and the implementation of reform.

Under these conditions, even a prompt and unambiguous elimination of uncertainties relating to the existence of the ruble area did not provide any guarantees whatsoever for successful implementation of a stabilization program. At the same time the preservation of these uncertainties deprived fiscal and monetary policies of clear guidelines and reduced to zero the chances such a program would be successfully implemented. The authors of the article consider three options regarding the evolution of the ruble area:

1. Its maintenance, had the republics agreed upon implementation of coordinated monetary and fiscal policies;
2. Maintenance of the ruble area, provided the Central Bank of Russia fully controlled the money supply, and
3. Liquidation of the ruble area and introduction of national currencies.

Allow me to take the liberty of asserting that the implementation of the first and second options in the economic and political context of 1991-92 was impracticable. The second option was simply impossible for political reasons. The first option I will deal with in greater detail. The authors note that the republics' stance vis-a-vis introducing national currencies was determined by political factors, by the desire to obtain real independence — and the Baltic states and Ukraine are given as examples of countries supporting rapid exit from the ruble area. Having spent countless hours negotiating with the Ukrainian authorities on this particular issue, I would rather disagree with the authors. Whilst rhetoric regarding introduction of national currencies was dictated by political considerations, actions were fueled by actual interests. The Ukrainian authorities had no desire whatsoever to abandon the ruble area, nor were they willing to discard the opportunity of exporting the Ukraine's emission to Russia and other CIS states. It was only the firm stand taken by Russian authorities that compelled Ukraine to make the decision to introduce its own currency in November 1992.

There is a clear difference in the interests of big and small states entering a single currency area. While the smaller countries objectively had stronger incentives to export their money supply and maximize seignorage, the larger countries found themselves importing inflation. With its economy accounting for more than 60% of the former Soviet Union's, Russia naturally had an interest in lowering its inflation. Other republics were sensibly seeking to cover part of the costs of post-socialist transition by printing money and exporting inflation, while the ruble area provided such an opportunity. The sums involved were politically and macroeconomically significant; despite all the imperfections in budget and monetary statistics of the time, the scale of transfer from Russia to other CIS countries was close to 10% of Russia's GDP.

It's pretty unrealistic to think that by signing an agreement on coordination of monetary and fiscal policies at the meeting of heads of central banks in Tashkent in May 1992, one could smash powerful interests underpinning the above-mentioned redistribution and radically alter the CIS states' economic policies. In December 1991 in Belovezhskaya Puscha, Russia, Ukraine and Belarus signed the first agreement on coordination of their budget and mon-

etary policies, and its effect was close to zero. In 1992, the CIS states signed dozens of documents on coordination that had an extremely limited impact on real life. For those aware of the realities of those days, it is hard to believe seriously that having got back from Tashkent, the Ukrainian central bank authorities could quickly persuade Messrs. L. Kravchuk and V. Fokin to change budget and monetary policies radically. I had an opportunity to discuss the Tashkent summit with some of its participants and am profoundly convinced that the majority treated the IMF proposal as a document with no mandatory force, allowing them to continue exporting inflation.

At that time the real choice was: to maintain the ruble area with uncoordinated monetary and budget policies, or the rapid introduction of national currencies. Only the latter option gave the stabilization program a chance of success. In view of this, in 1992 debate regarding the ruble area in the CIS and especially in Russia overlapped almost entirely with discussion on whether the country needed a serious monetary and financial stabilization program. Clearly the idea that within a single Ruble Zone it was possible to have a viable combination of tight monetary policy in Russia and rapid monetary expansion in Ukraine (as actually happened in the second quarter 1992), with wages in Kiev greatly exceeding those in Moscow, was beyond any politically realistic agenda.

There were two powerful forces forming an alliance in their struggle for maintenance of the ruble area – that is, the leadership of other CIS states apart from Russia and a considerable section of the Russian economic and political elite. While the former were scared of losing revenues from seignorage, the latter never supported stabilization efforts of their government and were keen to retain the possibility to redistribute inflationary revenues. Interestingly, both referred primarily to the need to retain long-term economic ties and "brotherhood". This was the background against which the IMF had to form its position on the key issue – that is, the ruble area.

The authors of the article are very sincere in highlighting the key factor that influenced the Fund's stand – namely, the Fund's unwillingness to have its stand interpreted as a pro- or anti-Russian one. The authors rightly note that while vigorous support of a rapid introduction of national currencies could be interpreted as a pro-Russian stand, favoring maintenance of the ruble area could be perceived as anti-Russian. That compelled the Fund to adopt a technical approach under which the decision was to be made entirely by the states in the ruble area, while the Fund was only to ensure its qualified expert assistance. In addition, as the authors point out:

In view of the size of Russia and its commitments to seek macroeconomic stability, and the absence of similar commitments elsewhere, it seemed in the first half 1992 that a cooperative ruble area arrangement in which Russia would de facto provide the nominal anchor would be more likely to produce macroeconomic stability in most countries in the region than a system of national currencies.[2] (Odling-Smee, 2002, p. 15)

The Fund began to express a clearer position in favor of introducing national currencies only when it had become clear that the attempt to burden Russia with the additional task of macroeconomic stabilization in other CIS states had undermined the support for anti-inflationary policy in Russia itself.[3]

The authors rightly argue that the destiny of the ruble area was dependent primarily on the balance of forces and interests in Russia and other Commonwealth states. In addition, the path to its dismantling and the introduction of national currencies was littered with serious technical difficulties, such as the need for radical changes to the whole system of settlements, to say nothing of introducing cash into circulation in the noted countries.

It is impossible to answer the question of whether, had the Fund provided the most vigorous and unambiguous support to a rapid introduction of national currencies, it would have been possible to solve the noted problems. However, it is a cruel irony of history that when the chances for success of a difficult stabilization program in a major country largely depended on achieving sovereignty in the area of monetary policy, the most important international institution — the IMF — for understandable and cogent political reasons was forced to take up a vague position.

Notes

1. The emergence of the situation in the territory of the former USSR could resemble the situation in Yugoslavia. However by that time the latter had long been a market – oriented socialist economy. As far as Czhechoslovakia is concerned, the "divorce" was well organized there, and it was completed in the frame of already functioning market economy.
2. While at the negotiations with the IMF in June 1992 in Washington D.C. I drew the IMF authorities' attention to the fact that the magnitude of money expansion in Ukraine and its export to Russia undermined chances for success of our stabilization program, one of my counterparts commented that in view of economic logic, in that situation Russia was required to exercise additional efforts in regard to tightening its monetary policy to compensate for monetary expansion in the CIS. The advice was correct from technical perspective, but could not be implemented due to political reasons.
3. Odling-Smee (2002), pp. 19-21.

References

Odling-Smee, John, and Gonzalo Pastor, "The IMF and the Ruble Area, 1991-93", *Comparative Economic Studies*, 44, (4), 2002, pp. 3-29.