Book Review

The Economics of Russian Transition
Yegor Gaidar (ed)


This formidable book, organised into 26 chapters plus 6 scientific and statistical appendices, provides very detailed testimony and analysis of a group of economists, most members of the Institute of Economic Transition (IET) headed by Gaidar, intermittently at or near the helm of the Russian Government and the reforms during 1991–1993, and later leader of ‘Democratic Choice’, a liberal, market-oriented party in the Duma.

Most of the chapters in the book focus on 1992–1998, the formative and most turbulent years of the transition, but some go beyond up to 2000–2001. During all these times, IET provided background research, position and policy papers and draft laws to the reformist segment of the government and Duma. Such work for the government and Duma continued even when officials pursued more ‘leftist’ and conservative policies, a disclosure to the reader who may wonder about the relationship of the IET group with the policy-makers in later years.

In the space allowed, I can cover only part of the rich and highly valuable content of this volume. The following selection is based on what emerged as the main issues of the transition, my own biases, and elements less emphasised in the vast literature on covered topics.

At the outset of the volume, Gaidar and Vladimir Mau link the post-communist transition to the nature and heritage of the communist regime. As in other revolutions, when the government is most needed, it is very weak, because of the struggle between would-be winners and possible losers and owing to the deep fiscal crisis resulting from the collapse of the old public revenue system and a lag in the adjustment of expenditures to the emerging but smaller tax base. As reasons for the collapse of the communist system Gaidar emphasises the distorted structure of the economy – too large and dominant an industrial sector with a weak agricultural one. The collapse of the system came when Gorbachev tried to reform it. In Gaidar’s view this was impossible. The communist system was so rigid and inseparable that it could not be bent or partially reformed; it could only break up. This is an important explanation for why the change did not start during the mid-1960s. A second
explanation is the energy boom of 1973–1984, which helped the USSR disguise the ills of the system, allowed it to muddle through for a while, and postpone the change.

Eleven chapters, covering more than 300 pages, are devoted to a very detailed analysis of the issues of macroeconomic stabilisation, a struggle on how to transform and stabilise a centrally planned economy and shift to market principles. This is a story of the record of a handful of inexperienced policy-makers with only a few tools – fewer than the number of targets to be reached – mostly weak and inefficient, working in a politically fragmented environment. A desirable liberalisation of foreign trade and capital flow, depressed domestic production (besides natural resources) too much, partly as a result of an overappreciation of the rouble. Starting in 1995, the rouble exchange rate was installed as a ‘nominal anchor’ to help fight inflation, leading along with other factors to the 1998 financial crisis. The crisis itself and the resulting sharp real devaluation of the rouble helped later on to ease the pressure on domestic production, at least for a time. One wonders, then, if it would have been better to engineer a more gradual process of devaluation, even before 1995, to reach the post-crisis rouble/dollar rate later on. Such a policy would have required alternative or additional tools to control inflation. In the concluding chapter, the authors assert that the post-crisis level of the exchange rate also helped to reconcile the political tensions among various groups, including exporters and the producers of goods for the domestic market. Paradoxically, the unintended 1998 crisis and the devaluation contributed to macro-economic stabilisation and recovery of production more than many other deliberate policy steps.

From the start macroeconomic stabilisation had also depended on fiscal policy. Very sharp cuts in budget expenditures devoted to investment, defence, subsidies to productive sectors, including agriculture, as well as social services, were envisioned. Over the years there were struggles to preserve and extend these cuts on account of the collapsing tax collection system. Nevertheless, substantial expenditures were allowed over time in these categories in response to pressures of interest groups and political parties by means of extra-budgetary funds and credits issued by the central bank via the banking sector. When the rates of inflation subsided somewhat during the mid-1990s, the government resorted to the financing of its deficit through the issue of domestic bonds (GKOs). Probably in order to sustain the failing banking sector, it did not allow foreign investors to buy them. In retrospect, foreign holdings of GKOs might have mitigated the crisis. Even though the burden of debt on the Russian government during that period was moderate by international standards, the risk generated by the internal economic and political environment and from the global conditions pushed
the interest rates on these bonds up to unsustainable levels. While the banks failed in the crisis, regrettably this experience was not used as an opportunity to reform the banking system.

While price stabilisation was at all times a declared goal of the government, there was a school of thought, centered in the Russian Academy of Sciences that advocated some inflation to break the steep fall in output. This school supported budget expansionists in the government, the central bank, and in the economy. Another unexpected voice against prompt stabilisation was Anatoly Chubais, a reformer and leader of the privatisation drive. He believed that premature stabilisation, before enough privatisation had taken place might have opened the door for the return of the old regime. Stabilisation might also slow the privatisation process by making credit to potential buyers more expensive, as I heard from him in 1992.

In the chapters devoted to the privatisation process and associated institutional reforms, there are no new arguments in the debate between suboptimal but fast privatisation and a more orderly, but gradual one. The chapters on corporate governance reveal, however, a long list of mistakes, misdeeds, corruption, state capture and plunder, rigged tenders, weak institutions, little or no enforcement, and so forth. Furthermore, in most cases privatisation did not provide able managements, so restructuring lagged behind. Because of all these and the resulting very weak protection of property rights there was also too little investment. It still may be true that the privatisation process as implemented was better than any feasible alternative – for instance, ‘spontaneous privatisation’ – that would have guaranteed non-reversibility of market reforms. However, after going through these accounts the balance of the argument shifts further in the direction of some alternative, at least in my view.

It should be remembered that this volume was written from the vantage point of 2000–2001, when Vladimir Putin’s intent of establishing more order and a long-term reform agenda in the right direction (the Gref programme) was announced, but before some of the less favourable developments in the following years. Even given the still extremely weak status of rights of property owners, and more so of minority shareholders and foreign investors, as well as the other deficiencies of the privatisation process, there was a supposition when this volume was completed that the existing distribution of property ownership was more or less accepted by the government and the public and would not be tampered with, not to speak of any re-nationalisation. As we know now, this supposition turned out to be premature.

The chapter on the Russian banking sector provides a rather grim testimony on the irrelevance of the banks as a source of funds for investment
and the reconstruction of the real sector. During the surveyed period the banking sector in Russia was part of the problem, rather than a tool useful for the solution. Many East European transition countries bridged that gap by ‘importing’ banks from the West on a grand scale and with some positive results. This has not happened in Russia in any significant way. One reason is the dominant role of the State Saving Bank (Sberbank), which still held about three-quarters of all deposits in 2000.

Natalia Karlova, Eugenia Serova, and others provide useful analyses of the agricultural situation in Russia, a subject on which there is little done in the West. Their most telling observation is that whatever move to market relations and private property took place, it was manifested in the transformation of the collective and state farms into quasi-commercial and business-like corporations, rather than through the creation of private, family farms and the dissolution of the previous types, as was expected early on.

Two chapters contain good summaries of the main developments in the labour market and the household sector, but do not fully meet the challenge of weighing the heavy social costs against the achievements of the reforms.

At the end of 2000, the authors could conclude with much satisfaction. The newly achieved political consolidation and stability following the turbulent 1990s provided a solid base for economic stability, continuation of reforms, and a resumption of economic growth. With the peaceful replacement of Boris Yeltsin by Vladimir Putin, obedience of the Duma to the executive branch and the stricter control imposed on the 89 federal regions are cited as evidence of stability. The comparatively low rate of inflation and balanced budget, partly accomplished through a radical tax reform, would allow a more sensible privatisation process, free of fiscal pressures, as well as more foreign investments and more attention to social issues. For the first time the growth of production in the processing industries outpaced that of the extractive ones. The concluding chapter presents in great detail the ‘Strategic Program for Russia’s Social and Economic Development’ (the Gref programme), which along with the foreword contributed by Stanley Fischer, contains a long list of still pending reforms and how to implement them. A critical mass of transition had been accomplished, a respectable part thereof owing to Gaidar and the group of young economists around him. At that time the transition appeared not only irreversible, but even within reach. Irreversible it still is, but yet far from being accomplished.

At the end of February 2006, the IET celebrated its 15th anniversary together with the 50th birthday of Yegor Gaidar himself. The changes in the policies of the Putin regime since 2002–2003, symbolised by the Yukos affair, have moved towards a more pronounced ‘state capitalism’, or even toward a ‘corporate state’, as asserted by former Putin adviser Andrei Illarionov.
There have been several key cases of re-nationalisation and ‘a serious threat of evolving towards an authoritarian regime and a “closed democracy”’, as Gaidar termed it in a lecture at the World Bank in January 2004. He and his colleagues at the IET and others will have to work harder and longer on the transition of Russia to a democratic state and a market economy. The present book is therefore an intermediate report on the transition rather than a final one.

Gur Ofer
The Hebrew University of Jerusalem, Jerusalem, Israel