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# RUSSIA'S ECONOMIC TRANSFORMATION IN THE 1990s

EDITED BY Anders Åslund

# **Russia's Economic Transformation in the 1990s**

*Edited by*  
Anders Åslund



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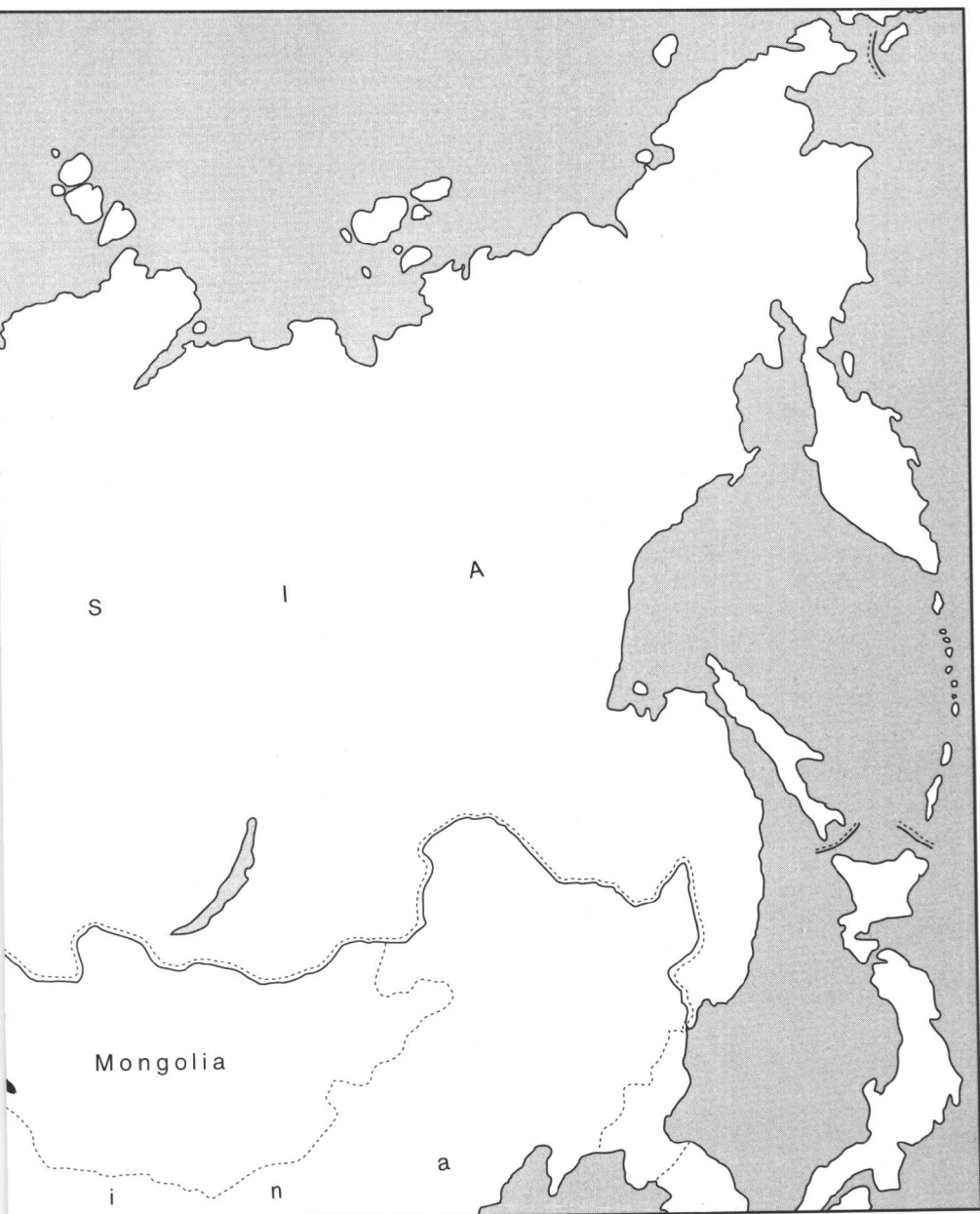
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Russia and its Neighbouring Countries



**K** identifies the Kalingrad Region which is part of (but physically separated from) Russia, and **N** likewise Nakhichevan which is part of Azerbaijan. The twelve countries identified by numbers are: **1** Estonia; **2** Latvia; **3** Lithuania; **4** Moldova; **5** Georgia; **6** Armenia; **7** Azerbaijan; **8** Tajikistan; **9** Kyrgyzstan; **10** Czech Republic; **11** Slovakia; **12** Hungary.



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# Introduction

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At the end of 1991, when the Soviet Union still existed, President Yeltsin formed a Russian government designed to pursue radical economic reform. A veritable change of economic system was launched in January 1992, and Russia was transformed into a market economy. However, in comparison with reforms in several other post-Communist countries, those in Russia hardly qualify as radical.<sup>1</sup>

This book is a collection of papers on the Russian economic transformation written from 1991 until 1994, and it offers a unique inside perspective of the reform process. All the papers are written by people, who were deeply involved in the economic reforms, either as senior Russian policy-makers or as foreign advisers to the Russian government, and the articles were written at the height of the reform. They reflect what the chief reformers and their advisers knew and thought, while they were attempting a radical transformation of Russia. The contributors advocate radical reform, mostly supporting the government, but sometimes criticizing it for not being sufficiently radical.

The origin of this volume is a series of four conferences held in June each year from 1991 till 1994 in Stockholm, at the Stockholm Institute of East European Economics at the Stockholm School of Economics. At the time, I was the director of that Institute. This was a rare and important exercise in co-operation between Russian and Western economists favouring radical post-Communist reform in Russia. Each of the conferences resulted in a conference volume, edited by me and in one case co-edited with Richard Layard.

The first conference was held in June 1991, when the Soviet Union was plunging into a profound economic crisis. The meeting was characterized by a strong feeling among both Russian and Western participants that things could not go on like that much longer (Åslund, 1992). Most of the participants saw not only an horrendous economic crisis, but also an opportunity to make a fundamental break to a free market economy. The seemingly successful Polish radical reform dominated the discussion on what to do. Most also thought that the Soviet Union was over, and that we had to look to Russia for the desired radical reforms.

In June 1992, the attempt at radical economic reform had been made, but at our conference the mood was pretty sombre (Åslund and Layard, 1993).

The participants realized that the reform had not become as radical as virtually all of us had hoped for, and it seemed to be unravelling. Privatization had not really started, while the stabilization attempt was still fledgling, and liberalization had stopped far short of our expectations.

The April 1993 referendum offered a happy surprise with popular support not only for President Yeltsin but also for radical economic reform. In parallel, the mass privatization was making great strides. The June 1993 conference was therefore held in a cheerful spirit, but our optimism did not prove sustainable (Åslund, 1994). 1993 was a year of fluctuating policies, though also of considerable achievements. Subsidized credits, the rouble zone and import subsidies were eliminated.

In 1994, it appeared once again as if financial stabilization was around the corner. However, the undoing of the stabilization attempt was already under way, as some participants argued (Åslund, 1995). The fall of 1994 saw no financial stabilization, but an exchange rate crisis, labelled 'Black Tuesday' (11 October). Only in 1995, a regular financial stabilization finally took hold, and inflation was brought under control in 1996.

These conferences attracted contributions from a great many Russian economists and policy-makers: Anatoly Chubais, Boris Fedorov, Aleksandr Shokhin, Yevgeny Yasin, Petr Aven, Maxim Boycko, Sergei Vasiliev, Sergei Aleksashenko, Vladimir Kosmarsky, Andrei Kazmin, Aleksei Mozhin, Vitaly Naishul, Andrei Vavilov, Leonid Grigoriev, Andrei Illarionov, Grigori Khanin, Aleksandr Bim, Aleksei Ulyukaev, Irina Boeva, Tatiana Dolgopiatova. Western contributors were notably: Jeffrey Sachs, Richard Layard, Marek Dabrowski, Andrei Shleifer, Stanley Fischer, Charles Wyplosz, Peter Boone, Ardo Hansson, Simon Johnson, Jacek Rostowski, Stuart Brown, Pekka Sutela, Brigitte Granville, Judith Shapiro, and Jaques Delpla. Many others participated, including Rudiger Dornbusch, Michael Bruno, Ronald McKinnon, John Flemming and Olivier Blanchard.

This volume represents an attempt to select the best and most cited articles. It focuses on the main contributors, but it also reflects an attempt to balance the selection in several regards. There are approximately as many Russian as Western contributors, and different themes are somewhat balanced. All the volumes are represented, though not with equal weight. I have tried to avoid several contributions by the same authors, though two authors do recur.

Many papers had to be excluded because they were dated, for instance, containing detailed predictions or prescriptions specified with numbers or dated statistics. Naturally, this approach leads to a bias towards reflective or historical papers. Since the papers largely represented a radical reform consensus from the outset, no balancing by views has been necessary.

Unlike many a Soviet editor of historical works, my ambition has been to provide the reader with the naked truth in original. Therefore, I have abstained from re-editing the articles, apart from correcting a few minor typographical errors, cutting a couple of appendices and a few tables to save space.

This volume contains eleven chapters, and it is divided into four parts. The first two chapters discuss preconditions of the reform. The second part

contains three chapters about liberalization and privatization. Four chapters on macro-economic stabilization comprise the third part, and the last part consists of two chapters providing a social evaluation of the transition. Only one chapter has been taken from the conference in 1991, while four derive from the 1992 conference, two from the 1993 conference, and four from the 1994 conference.

The first chapter in this volume is my own 'Critique of Soviet Reform Plans', written in 1991. I think it is worthwhile to refresh the reader's memory about the state of the economic thinking in Russia just before the reforms. My chapter is a critique of the most significant Soviet reform plans. It draws lessons from the transition process in East-Central Europe. A major point in this chapter is that democracy is of vital importance for successful systemic change in formerly socialist countries. Moreover, surprisingly, many problems stemmed from intellectual inability to conceptualize a market economy. Typical flaws were an unfounded belief in gradual transition, implying both slow price liberalization and a gradual reduction of the budget deficit, while the socialist economists had excessive confidence in the capabilities of the state apparatus and failed to comprehend the high costs of transition.

Sergei A. Vasiliev was the author of 'Social, Political and Institutional Aspects', which also deals with preconditions for reform. It was written in 1992. At the time, Sergei Vasiliev was the head of the Russian government's Centre for Economic Reform – an in-house think-tank, and he is presently Deputy Minister of Economy. In this chapter, Vasiliev goes through social, political and economic intricacies. His conclusion is that, on the one hand, the preconditions for building a market economy are meagre in Russia. On the other hand, he sees no other solution than a market economy. Hence, he sees persistent contradictions that will lead to a long-lasting crisis in Russia. In particular, he doubts that macro-economic stabilization can be successful before substantial institutional changes have been undertaken, including the development of democratic institutions, privatization and a market infrastructure, which inevitably requires some time. Today, this chapter stands out as particularly prophetic.

In the part on liberalization and privatization, Marek Dabrowski has written the first chapter, 'The First Half-Year of Russian Transformation', also from 1992. Dabrowski was and remains a Professor of Economics working at the Centre for Social and Economic Research in Warsaw. He was First Deputy Minister of Finance during the radical reforms in Poland in 1989 and 1990. He remained a Polish MP and worked as an economic adviser to the Russian reform government. Dabrowski provides a broad assessment of the first half-year of the Russian transformation, comparing intentions with outcome. His general assessment is pretty pessimistic. Both liberalization and macro-economic stabilization had been half-hearted. Already the concept of the reform was not sufficiently comprehensive and radical, and the outcome had been considerably worse. Dabrowski emphasizes that the initial conditions were so difficult that the problems were rather understandable, but more lessons should have been drawn from the Polish experience.

Petr O. Aven discusses 'Problems in Foreign Trade Regulation in the

Russian Economic Reform' in a paper from 1993. He recounts his experiences as Minister of Foreign Economic Relations of Russia from November 1991 until December 1992. Aven is now President of Alfa Bank. He offers a forceful account of all the problems he faced. He draws rather diverse conclusions, sometimes defending the slow deregulation of Russian foreign trade, but his main lesson is that 'any obstacle to economic activity . . . will be circumvented in Russia, and therefore, this country has to be more liberal than any other'.

Anatoly Chubais and Maria Vishnevskaya have contributed the chapter on privatization, 'Main Issues of Privatization in Russia', written in 1992. Chubais was Minister of Privatization from November 1991 till November 1994, as well as Deputy Prime Minister. At present, Chubais is the head of President Yeltsin's administration. Vishnevskaya is his wife and formerly his co-researcher. In this early chapter, they draw up the main features of the Russian privatization programme. The reader will be struck by the consistency in the government's privatization policies. This degree of correlation between a government programme, legislation and its implementation is rare in Russia. Today, we can see that Chubais knew what he wanted to do, and he did it.

The 1992 chapter by Jeffrey Sachs and David Lipton is called 'Remaining Steps to a Market-Based Monetary System'. At the time, both were economic advisers to the Russian government. Jeffrey Sachs is a Professor of Economics at Harvard University, and David Lipton was a Fellow at the World Institute for Development Economics Research. Today, he is Assistant Secretary of the US Treasury. Their chapter is a thorough analysis of the peculiarities of the Russian monetary arrangements just after Communism. Their view is: 'The monetary problems facing Russia are perhaps the most complex in world history.' They also suggest comprehensive solutions. Their chapter offers an outline of a whole new monetary system for Russia, but the key issue was to clarify the rouble area and its monetary regime. Much of what Sachs and Lipton proposed at the time has later been adopted, but not all. During the delay, Russia saw far too high inflation. (Two prescriptive technical appendices have been omitted.)

The most shocking failure in the transition to a market economy in the former Soviet Union was the maintenance of the rouble zone, in which several central banks issued the same currency without coordination, until late 1993. Brigitte Granville is a Senior Research Fellow at the Royal Institute of International Affairs in London, and has worked for a long time as an economic consultant in Moscow with the Russian government. In her chapter, 'Farewell, Rouble Zone', she tries to explain how such a situation could arise and analyses its effects. Granville reviews the arguments against the preservation of the rouble zone. A major consequence was a large outflow of financial resources from Russia to the other former Soviet republics. The overall result was high inflation in the whole rouble zone. Granville outlines the various stages of the dissolution of the rouble zone. However necessary it was, the dissolution was so poorly prepared and undertaken that two-thirds of the fifteen former Soviet republics ended up with hyperinflation. Still, the introduction of separate, increasingly convertible currencies provides a base

both for domestic stabilization and revived trade between the former Soviet republics.

From December 1992 until January 1994, Boris G. Fedorov was Minister of Finance and Deputy Prime Minister of Russia. At present, Fedorov is a Deputy of the State Duma, chairman of the political party 'Forward Russia', and chairman of the United Financial Group, a Moscow investment bank. In his article 'Macro-economic Policy and Stabilization in Russia', he draws lessons from his time as Minister of Finance and reviews the state of affairs in the middle of 1994. He emphasized the lack of real macro-economic policy and called for a proper macro-economic stabilization. Very accurately, Fedorov foresaw rising inflation during the second half of 1994 because of this lack of macro-economic policy and government rigour. He argued that without full stabilization, production would continue to fall, while bankruptcies and unemployment would increase moderately, as indeed was the case.

Considering his great intellectual contribution to the Russian transformation and debate, it appears appropriate to let Jeffrey D. Sachs sum up 'Why Russia Has Failed to Stabilize'. This paper was written in late 1994 when Sachs no longer advised the Russian government. His fundamental argument is that despite all the uproar over 'shock therapy' in Russia, this did not really happen. He outlines what a true shock therapy should have entailed, but he observes that only at the end of 1994 had these elements formed the agenda of negotiations between the IMF and the Russian government, although all these measures could have been undertaken in 1992. The economic and technical preconditions for a real macro-economic stabilization have been established, but only gradually. In the meantime, public opinion has turned against reform, and most reformers have fallen out of government. Sachs' key question is how much economic mismanagement can Russian politics bear. We may add that the answer from the presidential elections in the summer of 1996 is: more than hardly anybody could have imagined.

The fourth and last part of the book contains two chapters with a social evaluation of the reforms. In a paper from 1993, Andrei Illarionov, Richard Layard and Peter Orszag assess 'The Conditions of Life'. At the time, Andrei Illarionov was chief economic adviser to Prime Minister Viktor Chernomyrdin, and now he is Director of the Institute of Economic Analysis in Moscow. Richard Layard is Professor of Economics at the London School of Economics and has been advising the Russian government continuously since November 1991. Peter Orszag and Andrea Richter (contributor to the next paper) worked with Professor Layard in Moscow and later on as staff economists at the Council of Economic Advisors of the US Government. Admirably, the authors go through and interpret all kinds of relevant statistics and put them in perspective. They found a substantial decline in average consumption, but a small reduction in food consumption. Social inequality as well as regional inequality had risen, as is generally perceived. The authors found that large families were worst hit by poverty, since child allowances had lagged behind other social transfers. Yet, unemployment remained low.

In the final chapter, Richard Layard and Andrea Richter reflect on 'Labour Market Adjustment: The Russian Way'. Their observations are rather

controversial. Throughout the initial transition period in Russia, various bodies issued patently exaggerated forecasts of unemployment. In reality, actual Russian unemployment has stayed low by international standards. In this carefully argued paper, Layard and Richter go through all the plentiful statistical evidence at hand on Russian unemployment. They guide us through a web of seemingly contradictory numbers, and they manage to show lucidly and convincingly that actual unemployment in early 1994 was almost 6 per cent – in sharp contrast to the overstated numbers provided by the International Labor Organization in Geneva. Moreover, they established that the Russian labour market was characterized by a very high mobility. They found amazingly flexible real wages and few lay-offs. The problem in Russia appears to be less a problem of unemployment than of low wages of the working poor.

The two last chapters contain many tables and a great deal of statistics. Even if some official statistics used have been revised, the changes have been minor. I have preferred not to alter the statistics to show the picture as it appeared at the time of this analysis. A few appendices and figures of minor relevance have been excluded to save space.

I have added a brief epilogue to set the events discussed in this book in some perspective.

Acknowledgements are due to all the many participants in these conferences, as well as the staff of the Stockholm Institute of East European Economics, who helped organize this large project. The advisory project for the Russian government that Jeffrey Sachs and I ran was financed by the Ford Foundation and the government of Sweden. I am particularly grateful to Frances Pinter, who enthusiastically published the original four volumes arising from these conferences.

Anders Åslund  
Carnegie Endowment for International Peace  
Washington, DC  
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## Notes

1. In Åslund, *et al.*, 1996, p. 219, we define 'radical reform' by two criteria – the degree of financial stabilization and the degree of liberalization. Both measures are made ex-post and no ex-ante. By our definition, Russia's reform did not qualify as radical, while the reforms in Poland, Czechoslovakia, Albania, Estonia and Latvia did.

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