

WHITHER RUSSIA ?

By

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I have just been in Russia for the first time since the mid 1990s, to attend a conference organized by President Putin's economic advisor Andrei Illianorov and the Cato Institute. My impressions of what has been achieved in the way of economic reforms in Russia, and the current political situation in Russia are at odds with much conventional wisdom about Russia, including the fears expressed by many Western observers about the rising authoritarianism of the Putin regime. In this column I want to build on a previous column on Russia to examine what has been achieved and what form the future of Russia might take.

There are two important points to be made in thinking about the economic and political reforms in Russia with the demise of the Soviet Union. One concerns the economy, the second the polity.

As my previous column noted, the most important feature of the Soviet economy was that it was based on using the rents from the vast natural resources of the country to subsidise most of the working population, by employing them in industries where value added at world prices was usually negative. Much of Soviet industry was thus valueless. The only wealth-creating sector was the natural resource one, and it indirectly provided the livelihoods as well as various forms of welfare- from the cradle to the grave- in the monolithic state enterprises, which, moreover, were regionally dispersed in the form of company towns. With the necessary price reforms after the fall of the Soviet Union, which aligned Russian relative prices with world prices, most of these enterprises were bankrupt. The hope of the liberal reformers Chubais and Gaidar during the early years of the Yeltsin regime was that, the voucher privatization that was adopted would depoliticize economic decision-making and lead to the restructuring of these enterprises to make them economically viable. Despite the continuing debates about the form of privatization adopted by Russia, and the 'shock treatment' administered by Gaidar and his associates, I still think that this was the right route, and in one stroke succeeded in depoliticising many but not all economic decision making in Russia. There was no other way for the country to move however imperfectly from the plan to the market. It was the very incompleteness of these reforms, which has subsequently come to haunt the Russian economy.

The reason why the reformers balked at closing down all the loss making industrial enterprises in Russia was their role in providing the social safety net that was needed at a time of extreme dislocation when the old planning system was dismantled. Ideally, a transparent tax-subsidy system should have been set up. So that, instead of providing the social safety net by employing people in subsidized loss making enterprises financed by natural resource rents, they could have been directly provided 'welfare' payments financed by taxes on the natural resource sector. The enterprises, which in effect were destroying economic value, could have then been shut down. Many of the current problems facing Russia could have been avoided. Given the continuing hold of

'conservatives' in the Duma, and the complex administrative structure needed to implement the tax -subsidy system- when with the demise of the Communist party the former State apparatus had been dismantled- such a solution would not have been feasible. Hence the hope that privatization of most industries, but not of the major source of natural resource rents- Gazprom – would allow both efficiency gains and the continuance of the social safety net.

In the privatization process many firms came to be under the control of their previous managers. (see Boycko, Sheifer, Vishny: ""Privatizing Russia")In association with local governments and the main natural resource state owned company –Gazprom- a complex system developed for channeling natural resource rents to subsidise the social safety net provided by bankrupt firms. (see C.G.Gaddy and B.W.Ickes: "Russia's Virtual Economy", Brookings, 2002) But, there have also been undoubted efficiency gains from privatization in both the industrial firms which have been restructured, and the natural resource industries- like oil-, which were privatized.

But, the 'loans for shares' scheme adopted in the later years of the Yeltsin regime, which allowed the so called oligarchs to gain control of these economically viable firms, meant that the general public -which voluntarily sold their privatized shares to the entrepreneurs who have brought about these efficiency gains- did not itself benefit. The legality of the acquisitions by the oligarchs is still hotly debated, but as one of them Boris Berzevosky - now in political exile in London- has said, there was money just lying around, and he has no idea if it was legal or illegal to pick it up. One remarkable fact about the oligarchs is that they are nearly all mathematicians and natural scientists who were employed in state research institutions. Berezvosky told me that his highest ambition had been to become an Academician, till a trip to Germany in the early 1990's showed him the opportunity to make money by importing Mercedes cars into Russia.

These oligarchs like the misnamed 'robber barons' in late 19th century America are genuine entrepreneurs and have undoubtedly -like their US predecessors- created wealth. Their mistake has been to try to directly influence politics. The concentration of wealth in their hands is bemoaned in a recent World Bank report. Its recommendation that Russia adopt anti-trust legislation on the lines of the US Sherman Act is misguided for the same reasons as I set out in an earlier column on competition policy in India. The oligarchs need to be cherished rather than hounded. I have a feeling President Putin recognises this, and the imprisonment of Khodorkovsky on tax evasion charges is merely a shot across the bows to warn other oligarchs not to try to subvert the polity, and most important, to induce them to give a fair share of the natural resource rents generated by their enterprises to the State- as this is crucial in ending the virtual economy of the unreconstructed industrial enterprises which currently provide social safety nets in Russia.

So is Putin, who I believe genuinely wants to reform Russia, turning to the Pinochet Option, as many believe? I do not think so. Wandering through the Kremlin museum or the various museums of St. Petersburg, two things struck me. The first is that Russian rulers have always been authoritarian. It's geography and history have made it in many ways a savage place. The attempts to modernize Russia by Peter the Great and Catherine the Great were not gentle, constitutional exercises in creating a modern Russia. The second is that, given their history, the Russians must fear disorder. The chaos unleashed in the free wheeling democratic Yeltsin years, however appealing to Western

liberal democrats, must have been intolerable to the average Russian. I believe that Putin's manifesto of bringing order- albeit in quasi- authoritarian form- is popular in Russia, and the recent elections did in fact represent the people's will.

Even the emerging authoritarian traits are more reminiscent of the Tsars than Latin American dictators. The arrest of Khodorkovsky on tax evasion charges is typical of a tactic of control employed by the Tsars, who had numerous ways of keeping people in line, not by overt terror, but by creating a feeling that anyone might have unknowingly broken some law. India's FERA had a similar effect. This subtle means of maintaining control is in line with what the other great Russian reformers Peter the Great and Catherine the Great did in moving Russia into the modern world. Not Pinochet, but these two great reforming denizens of his native city- St. Petersburg- are I think President Putin's model. Whether he will be any more successful in modernizing Russia remains to be seen.