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Russian Retrospectives on Reforms from Yeltsin to Putin

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In the late 1980s, during the final years of the Union of Soviet Socialist Republics, Mikhail Gorbachev attempted to resuscitate the Soviet economy with a set of policies called *perestroika*. These policies involved some steps toward removing government economic controls, like leasing some land to farmers, allowing some small privately owned enterprises and closing down some loss-making factories. But *perestroika* also kept the economic planners fundamentally in charge. Gorbachev greatly overpromised what *perestroika* could achieve, and by 1991, it had proved a dismal failure at increasing output and living standards. The Soviet Union officially divided into separate states in December 1991, and in January 1992, Boris Yeltsin assumed charge as the first president of the Russian Federation. One of Yeltsin's primary goals was to end the planned Communist economy—not to reform it, but to finish it. To accomplish this goal, as Yeltsin later recalled in an incisive October 2003 interview published in *Moscow News:* "What was needed was a kamikaze crew that would step into the line of fire and forge ahead, however strong the general discontent might be. . . . I had to pick a team that would go up in flames but remain in history."

Yeltsin's reformers clearly achieved their goal of ending economic management in the style of Soviet Communism before they went up in flames. In only a few years, Russia's firms were no longer state-owned, its people could own property and firms, its government relied on taxes for collecting revenue, and its currency was traded on foreign exchange markets. But controversy over Yeltsin's economic reformers has raged ever since. With every disappointment or failure that Russia's

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economy has experienced since 1992, questions arise as to whether a different or amended path of economic reform might have worked better.

Given the number of claims being made about what the economic reformers should have done, it is useful to find out what the reformers were actually thinking and doing. Thus, I undertook an interview project with key participants in Russia's reforms over a period from 1999 to 2004. In this essay, I focus on how nine Russian interviewees looked back on Russia's political economy issues, including three principle economic reformers under Boris Yeltsin, three economic policy analysts, and three banking professionals.[1]

The Participants

The project's highlight included repeated interviews with the three principal economic reformers under Boris Yeltsin. Yegor Gaidar was Acting Prime Minister for a year in the government till his resignation in January 1993. Gaidar was known as the author of the "shock therapy" approach to Russian economic reform, which involved the rapid elimination of price controls and industrial subsidies. Anatoly Chubais was the architect of Russian privatization, an enormous task for an economy in which all means of production had been state-owned. Chubais carried out a plan in which 150 million Russians—every man, woman and child—received vouchers for purchasing shares in privatized firms, and in which two-thirds of all Russian workers were employed by privatized firms by 1997. However, enormous controversy has arisen over the extent to which ordinary citizens benefited from the privatization and the extent to which shares of Russian industry ended up in the hands of a relatively small number of owners. Boris Nemtsov is a liberal, pro-market politician, who served in a variety of roles since 1992: the young, innovative, reforming governor of Nizhnii Novgorod, a region of about four million people; the key minister in charge of monopoly policy; the key minister in charge of energy; and a member of the upper house of Parliament (the Council of Federation) in the early 1990s. He was active in Yeltsin's government until its resignation in August 1998 when the Russian ruble was hit with a financial crisis.

Yeltsin, looking back in his October 2003 interview, described Gaidar as "logical, coherent, and clear in his mind insofar as economic matters were concerned"; Chubais "as closer to me in spirit than the others"; and Nemtsov "as the most elusive, . . . a guerrilla, sort of." In my assessment, Gaidar came across (in

[1] The interviews included 16 people and went beyond economic policy to discuss Russian foreign policy, history, society and demography. The other interviewees not mentioned in this paper were Anatoly Vishnevsky, Russia's leading demographer and Director, Center for Demography and Human Ecology; Strobe Talbott, former Deputy Secretary of State in the Clinton administration; George Soros, financier and philanthropist; Jack Matlock, former U.S. Ambassador to the Soviet Union; Martin Malia, emeritus professor of history at the University of California, Berkeley; and Richard Pipes, emeritus professor of history at Harvard University and National Security Advisor in the Reagan administration. The full interviews will appear in my *Conversations on Russia* to be published in 2005.

three interviews between 2000, 2003 and late 2004) as the scholarly conceptualizer and policymaker; Chubais (in one interview in mid-1999) as the brass-tacks designer and enforcer of the necessary privatization measures; and Nemtsov (in four interviews between 2000 and late 2004) as the politician with a deft sales pitch. Together they generated a powerful pro-market synergy, while Yeltsin in hindsight complained that their "maximalism" "exasperated" him.

Grigorii Yavlinsky is the best known of the liberal academic economists who became involved in Russia's economic reform. Yavlinsky had been the head of the economic department of the USSR government. In 1989, he was a member of a prominent committee that designed a plan for how the economy could evolve to a market system in 500 days. When the plan was not implemented, Yavlinsky resigned. Throughout the 1990s he was a prominent figure in economic reform debates, including policy measures enacted under Nemtsov in the Nizhnii Novgorod region and a number of tax, budget and sectoral reforms. As the founder of the opposition Yabloko group, twice a presidential candidate and a fierce critic of the Yeltsin reforms, Yavlinsky has made a mark as the permanent oppositionist of Russian politics. In four interviews between 2000 and late 2004 that offered a blow-by-blow assessment of the economic reforms of the 1990s, Yavlinsky presented a strong pro-Western, liberal and reformist stance, but nonetheless opposed what he perceived as the extreme pro-market thrust of the Yeltsin team in favor of a social democratic approach. Equally vociferous in their criticism of Yeltsin and his agenda (in their mid-2003 and late 2004 interviews) were two eminent academic analysts with social democratic leanings. Sergei Rogov is Director of Moscow's Institute of USA and Canada Studies. Nodari Simonia is Director of the Moscow-based Institute for International Economy and International Relations. Rogov's institute is a leading think tank under the Russian Academy of Sciences, which provides advisory input on foreign policy, military and economic issues to Russian government agencies. Simonia's institute, similarly placed under the Russian Academy and the largest think tank in Russia, undertakes research on social, economic, military and foreign policy issues. Both institutes award undergraduate and graduate degrees.

Finally, three banking professionals responded with interviews that were crisply analytical and refreshingly candid. Sergei Dubinin, former Chairman of the Central Bank of Russia, under whose watch the ruble collapsed in August 1998, discussed the problems of steering monetary policy in the late 1990s in two interviews (between 2000 and 2003). Oleg Vyugin, Dubinin's successor as central bank deputy chairman, gave-first hand account of recent monetary policy formulation (in a 2003 conversation). Boris Jordan, who helped set up the Moscow office of Credit Suisse First Boston, and later Renaissance Capital, currently Russia's largest investment bank, talked about his experiences (in a mid-2003 interview) as a trailblazer on the Russian financial and investment scene.

In early September 2004, a group of terrorists attacked a school in Beslan, a small town in the Caucasus region of Russia, and over 330 hostages, including school children, were killed. President Vladimir Putin then proposed sweeping changes for consolidating presidential authority with a view to fighting terrorism.

Eight of the nine interviewees (except Chubais, whom I did not contact) corresponded with me in October 2004 with their reactions as to how Putin's proposals might affect Russia's continuing evolution to a democratic system and a liberal market economy.

Policy Framework of the Interview Project

Boris Yeltsin and his kamikaze crew were driven by the goal of ending the Soviet Communist ideology of a planned economy and its authoritarian political arrangements. Given this overriding strategic objective, their policy framework was marked by four features, which helped me steer the interview process.

First, the Yeltsin team deliberately avoided a negotiating stance with Communist legislators in the parliament. Following Yeltsin's election as Russian president in 1992, and the adoption of a constitution in late 1993 via a referendum, Russia began having parliamentary and presidential elections. Under Mikhail Gorbachev, limited election procedures had begun. A so-called legislature, the Supreme Soviet, was elected in 1990 by a general and direct vote of citizens with the dominating participation of the Communists. The Supreme Soviet originally consisted of two houses with a membership of 750 each. It met twice a year and gave legal stamp to the policies already decided by the party, with resolutions adopted unanimously by a show of hands. At the end of 1993, the Supreme Soviet was replaced with a parliament consisting of an upper house, the 178-member Federation Council, representing the elected governors and speakers of the legislatures of the 89 regions of Russia among its members, and the lower house, the 450-member Duma, with members elected every four years. Half the Duma members are currently elected on the basis of party lists proportionately to their electoral votes and the other half on the basis of single-mandate contests in constituencies throughout the country.

The Duma adopts budget and reform legislation. It can impeach the president and also remove the government at the end of three non-confidence motions. The Yeltsin crew was on a continuing collision course with the Communist left in the Duma, the lower house of the parliament, elected at the end of 1993. However, their policy blitzkrieg, usually confrontational, at times designed to outflank the adversary, also left the Communist Party in a defensive role, incapable of transforming its worn-out ideology into a new vision and an alternative choice for the Russian electorate.

Second, the reformers were largely indifferent to their program's acceptance by the public and its distributional impact on the losers. Perhaps some pain from transforming the Soviet-era arrangements was inevitable. However, the urgency of minimizing the costs for the most vulnerable groups was not even articulated in the design of their policies, much less in their implementation. The Yeltsin team was out-and-out technocratic, and perhaps not surprisingly, this helped lead to their departure from active politics.

Third, the Yeltsin economic reform team neglected the inadequate institutional underpinning under which the Soviet command economy was to be transformed into a market system. For example, Russia even now has a thin stock market, dominated by the oil industry. Although many firms are privatized in the sense that they are not state run, Russia's industrial structure is dominated by monopolies in a largely unregulated environment rather than by competitive, rule-bound companies. Ultimately, Yeltsin's reformers ended up enacting bold market-oriented and democratic reforms against the backdrop of a decaying Soviet system, rather than implementing them in a robust institutional environment.

Finally, Yeltsin's reformers were so successful in ending the old economic and political patterns of state control that Yeltsin began to be concerned over whether the government could exercise its legitimate powers effectively—especially in a country as vast as Russia with ostensible federal arrangements. His decision to anoint Vladimir Putin as his successor in late 1999 demonstrated his acute unease over the breakdown of political cohesion, and the urgency of restoring stability in Russia. "He [Putin] is not a maximalist, and this is what set him apart from others," Yeltsin responded in the October 2003 interview when questioned about his choice. Predictably, Putin set about the task of consolidating state authority and restoring order following his election as president in April 2000, which in turn prompted concerns as to whether Russia's nascent democracy was being undermined. The Russian voters decisively turned against Yeltsin-era reforms by defeating the liberal reformist groups and depriving Gaidar, Chubais, Nemtsov and Yavlinsky of their Duma memberships in the December 2003 election. After four years under Putin, Russians were ready to settle for a mild dose of authoritarianism promising further stability and steady economic gains, rather than opting for a Yeltsin-type liberal order that had aroused their expectations but largely excluded them from the hoped-for benefits.

Yeltsin, a confirmed anti-Communist, and his like-minded reformist team maneuvered tirelessly against the Communist Party. They largely succeeded, in the sense that the Communist Party's representation in the Duma declined in successive elections, and the party was virtually extinct after the December 2003 election. The sections that follow build upon this policy framework and rely on the interviews to discuss the key elements of the process of economic reform that led to the decline of Communism, the shock therapy economic reforms, the controversial privatization plans, the end of popular support for Yeltsin, the steady popularity of Putin and the prospects for rebuilding appropriate institutions and state power in Russia.

Who Killed Communism? Yeltsin versus Gorbachev

Yeltsin's reformist goal was categorical: "The [Soviet] political system had to be overturned, not just changed." In early 2000, Gaidar also summed up his assessment of the Communist Party in his interview: "In Russia, even during Soviet days, the Communist Party of the Soviet Union was not really a Marxist party, it was an imperial party. And the ideology of the Communist Party of the Russian Federation from the very beginning has been authoritarian and nationalistic. If you read the writing of Mr. [Gennadii] Zyuganov, the Communist leader, there is nothing there from Marxism. There is a lot there that resembles the writings of Hitler. . . . This is why they [the Communists] are dangerous. . . . The most dangerous moment in Russia's transition was the 1996 presidential elections [when Zyuganov instead of Yeltsin could have been elected president]. Now everybody accepts the idea that the Communists will never come to power in Russia. . . . [T]hey will never again rule Russia." Chubais was equally categorical in his pronouncement: "I do believe that everything that has happened in Russia in the last decade [of the last millennium] has been a fight between Communists and non-Communists to a greater extent than anywhere in eastern Europe and on a much bigger scale, with more risk than in Poland or in east European countries. . . . Our strategy is to win. We have to win. I mean we shall win. . . ." Nemtsov expressed his concern about the Communist opposition somewhat elliptically by drawing an outsider's contrast between Russian and American politics: "I wonder why people become politicians in America. Everything here, by contrast in Russia, is predictable. What will happen after the [2000] presidential elections here [in America]? Hardly anything. What will happen in New York City? Nothing earthshaking. But suppose Zyuganov becomes the Russian president. It will be a disaster."

But do Yeltsin and his team of reformers really deserve the credit for carrying out the radical changes that ended Communism? What about Mikhail Gorbachev's contribution to this demolition project? To what extent did Gorbachev's program of glasnost, literally "giving voice," and *perestroika*, implying economic restructuring, begin the process of undermining Soviet Communism?

Yavlinsky, Rogov and Simonia, three Gorbachev supporters with solid social democratic orientations resembling Gorbachev's, were eloquent in their assessment of Gorbachev's contributions in weakening Soviet arrangements. According to Yavlinsky, Gorbachev "was a liberator in a very special sense because he liberated Russians from the system which existed here for more than 70 years. . . . He took initiatives and issued decrees in rapid succession which weakened the Communist administrative apparatus. I think you should compare the progress on this front under Gorbachev with the initial situation in which the administrative structures under complete Communist party control managed everything." According to Rogov, "Gorbachev is a unique leader in Russian history because he initiated changes at a time when it was possible simply to continue. . . . Until Gorbachev, the majority of Soviet citizens never thought of alternative arrangements. His changes prompted people to start thinking about the possibility of a totally different system. That was a revolutionary move. People began searching for an ideal transparent system because they knew that the Soviet system was a big lie." Simonia was equally decisive in ranking Gorbachev's democratic credentials ahead of Yeltsin's: "That process [of democratization] started not with Yeltsin, but with Gorbachev. There was genuine freedom under Gorbachev. . . . Gradually, Yeltsin talked and acted like a czar. So he borrowed the institutions of democracy but the essence was traditional Russian."

In my own view, Gorbachev did not intend to destroy the commanding role and ideology of the Communist Party of the Soviet Union. He aimed at creating inner-party democracy within a single party system by proposing political changes that focused on the role of party functionaries and the procedures of electing them. But the monopoly of the Communist Party in the political life of the land was an article of faith that Gorbachev found difficult to give up (Desai, 1990, 1997). His proposed changes were also slow and zigzag because of a continuing apprehension on his part that he might be removed from office by the Communist brass. Perhaps the most damaging mistake of Gorbachev's presidency, which I brought up in an unrecorded interview with him in the summer of 1999, was that he did not legitimate his authority by seeking to be elected president by a popular vote in winter 1990. As late as May 1990, public opinion polls placed Gorbachev as the most popular leader, ahead of Yeltsin. Instead, Gorbachev was elected president on March 13, 1990, by an indirect vote of the Congress of People's Deputies, which in the Soviet days was the supreme body at the top of the party hierarchy. It met every five years and selected those who would manage the government on a day-to-day basis.[2] Thus, Gorbachev lacked the legitimacy of a democratically elected leader (a handicap that he acknowledged in the interview) with which he could have held the Communist Party Politburo at bay and perhaps survived the power struggle with Yeltsin, who was elected President of the Russian Republic later in June 1991. While Gorbachev liberated eastern Europe from Soviet control and introduced powerful winds of change in the Soviet Union, Yeltsin proved savvier by contesting and winning five elections in his political career, including the referendum of April 1993.

At a deeper level, Gorbachev's economic reforms failed because of his conviction that socialism, purged of its Stalinist aberrations, could promote economic efficiency under the openness of *glasnost.* Based on this belief, Gorbachev's orchestrated steps to loosen Communist Party political control remained ahead of measures to free the economy from administered prices, shaky budgetary management and state ownership and management of productive resources. Gorbachev believed that he needed to draw from the positive aspects of Soviet history and ground economic restructuring in a vision of Soviet society that did not reject the "essential" correctness of its revolutionary past. Gorbachev did not believe that he needed nor did he want to be seen walking over to Jeremy Bentham and Milton Friedman's corner (Desai, 1990).

Thus, Gorbachev's economic agenda from 1985 to 1991 was shot through with fundamental contradictions that went beyond policy muddles or technical lapses. For example, he thought that incentives could be created without private property

[2] The Congress of People's Deputies made important policy announcements, laid down major guidelines and elected the Central Committee, which, with over 300 members, was the policymaking body on a day-to-day basis.

and private ownership of the means of production. Soviet society would instead devise "socialist pluralism," "socialist competition," "socialist incentives" and the like (Gorbachev, 1987; Desai, 1990). He was an intellectual prisoner of the full-blooded socialist tradition, a mode of thinking that could not readily encompass the true functions of a market economy. Economic reforms under his leadership were piecemeal because none of the policymakers in charge—all operating in the socialist mindset—understood market reforms. Throughout Gorbachev's tenure, his policymakers thought in terms of raising prices via *diktat* rather than freeing them. Their approach to the problem of macroeconomic instability consisted of attempting to trim the fiscal imbalance—but instead they watched helplessly as budget deficits escalated (Desai, 1989). Privatizing productive economic assets was beyond their consideration.

Perhaps Yeltsin did not comprehend the market economy either, but he clearly wanted his firebrand reformers to purge the economy of the strangulating kit and caboodle of Communist economic arrangements. But could Yeltsin and his team undertake fast-track economic reforms in Russia's chaotic political and economic environment of the 1990s? From launching the shock therapy economic reforms in January 1992 to the ruble's meltdown in August 1998, successive reformist teams in the Yeltsin government attempted to enact changes while they battled recalcitrant Communist legislators. Popular support for Yeltsin and his economic reform program, at its height in the referendum of April 1993, had collapsed to less than 5 percent popularity when Yeltsin resigned in December 1999. My conversations brought out these dual aspects of the escalating legislative confrontation and the evaporating popular support as Yeltsin's reformers sought to push their policy agenda.

Shock Therapy Reforms in Russia: The Politics and Economics

The key policy choices aimed at ending the Communist policies of economic planning were well known: decontrolling prices from their administered levels; slashing the inordinately high budget deficit; privatizing the state-owned means of production; and opening the economy via foreign trade and capital account liberalization under a unified, market-determined ruble. The question facing the Yeltsin reformers was whether to undertake these goals gradually and incrementally or in a quick and sweeping manner that became known as "shock therapy."

The argument in favor of shock therapy is that during a time of extraordinary political change, sweeping changes are politically possible and the public is more willing to endure the pain of higher prices and economic dislocation. By contrast, slow-paced reforms that wait for a political consensus can prolong the resulting costs and dislocations long after politics had turned "ordinary," giving opponents of reform a chance to regroup and counterattack—with the result that reforms may never actually occur (Aslund, 1994). Poland took the shock therapy approach to economic reform in 1989, seizing a window of opportunity that opened up after a decade of political struggle with the Polish Communist regime under the Solidarity banner and the country's liberation from the Soviet bloc. Yeltsin's reformers expected the collapse of the Soviet Union and the launching of the Russian Federation in 1992 to open a window, at least for a short time, for sweeping reform. The economic decisions therefore had to be rapid fire.

The shock therapy policy framework as articulated by its prominent advocate Jeffrey Sachs (1994) included the following elements: prices are freed, while an abrupt tightening of the money supply accompanied by large cuts in government borrowing from the central bank serves as a shield against inflation, the exchange rate is pegged to the dollar or some other hard currency, and massive amounts of foreign aid are marshaled to support the stabilization effort. Defenders of these "big bang" tactics also emphasize that privatization is essential, even while acknowledging that it is complex and almost necessarily slow. On the other side, gradualists proposed escalating attacks on the budget deficit and inflation, supported by smaller and more realistic aid flows, and without recourse to an early hard pegging of the exchange rate. Such a gradualist program also advocated gradual price decontrol and privatization of state-owned assets (Desai, 1993, 1994, 1999, pp. 1–94).

When Yegor Gaidar launched the shock therapy economic reforms on January 2, 1992, he had hoped that presidential decrees backed by Yeltsin's personal authority would prevail over parliamentary recalcitrance. Prices were freed by decree. He then presented the Supreme Soviet with proposals that called for *eliminating* the budget deficit by the end of first quarter of 1992—a very aggressive step, given that Russia's budget deficit in 1991 had been 17 percent of GDP, according to IMF estimates. The proposed cuts in defense outlays, state-financed investments and subsidies to consumers and industry were Soviet-style fiats: there had been no consultations with parliament or the people. Nor was there a strategy of seeking a steady political majority within the Supreme Soviet, which was roughly divided into three equal factions: Communists, reformists and an unsteady middle group that could float in either direction. The escalating rift between the government and the Supreme Soviet ended with a bang in October 1993 when troops loyal to Yeltsin stormed a group of diehard members who had barricaded themselves into the parliament building in Moscow rather than comply with the president's order to disband.

Starting with the shock therapy approach, Russian politics failed to settle down into a give-and-take mode. The politics of consensus building was ruled out by the confrontational strategy of the Yeltsin crew, a pattern that continued up to the December 1999 Duma elections. Rogov, as a proponent of Gorbachev-style reforms, characterized the bare-knuckles approach of the Yeltsin team in this way: "The so-called Yeltsin liberals went for the right-wing conservative ideology of the U.S. as an alternative to the Communist planned economy. They exchanged Marxism-Leninism for Friedmanism." Rogov also pointed out that the overwhelming public support of 1991 for Yeltsin disappeared over time, as the economic reforms imposed high costs on ordinary Russians. "There were enormous expectations.

People came out by the thousands in the streets of Moscow demanding immediate and fundamental changes. Later they felt that they were betrayed. They were manipulated by the government. There was frustration followed by societal fragmentation. Since the expectations were so high, the letdown was massive too."

Public discontent with the Yeltsin reforms materialized from three directions. The freeing of prices caused prices of essential goods to rise dramatically, in a way that essentially wiped out people's savings accumulated during the Soviet days. Bread lines disappeared, but bread prices climbed higher than wages. Second, price decontrol also destabilized enterprise balance sheets, forcing them to withhold wage payments to workers and tax payments to the government, and shortfalls in budget revenues created government defaults of wage payments to state sector employees and pensions to retirees (Desai and Idson, 2000). The pervasive withholding of wages from workers and nonpayment of pensions to retirees from 1994 to 1998 intensified public discontent. Finally, the voucher scheme did not buy enough stock to be of significant value to an average Russian, and voucher privatization led to uneven and unregulated ownership.

The human cost of the economic reform program could have been less, if more resources were available for subsidizing the losers and for supplementing wage and pension payments. According to Gaidar, however, the issue of "material support" from the West was not critical. "The problem [in 1991] was the absence of a clear, liberalization strategy in terms of which you could define a policy framework in those days. . . . You could put in a lot of money and mess up the strategy. You could have less money, and come out better." In Gaidar's view, the name of the game was strategy, rather than the resource requirements for implementing its "policy framework" with less pain to the public. But Gaidar's liberalization strategy seemed to have no component for addressing those without wages or pensions, or for those who would win and lose as ownership of the means of production was transferred away from the state sector.

Russian Privatization

The privatization of Russia's state-owned assets happened in two stages. The first stage involved the distribution of vouchers worth 10,000 rubles to every man, woman and child in Russia, including workers and managers of firms, that could be used to purchase shares of the privatized companies. In the second stage of the privatization, the ownership shares of the Russian government in some of Russia's prized companies such as Norilsk Nickel were traded to a small number of oligarchs in exchange for loans to the state budget.

The first stage of the broad-based voucher plan stretching from December 1992 to mid-1994 was spearheaded by the desire to provide a political counterweight in support of privatization that could beat the Communist majority in the Congress of People's Deputies. The voucher privatization was launched hastily, but it was very popular politically, and the distribution of vouchers in the amount of

10,000 rubles to every man, woman and child sounded to many people like a pathway to asset ownership and instant wealth. The voucher privatization program helped give a resounding "yes" to Boris Yeltsin and his reforms in the subsequent April 1993 referendum (Desai, 1995; Boycko, Shleifer and Vishny, 1995).

But in practice, many people ended up receiving very little for their vouchers. Information about the real worth of factories put up for sale to owners of vouchers was highly incomplete. An absence of electronic transactions meant that the voucher-based offerings took place in a rough-and-ready sequential mode, which further contributed to uncertain and unequal outcomes for the voucher holders. Finally, domestic and foreign middlemen bought up the vouchers from cash-hungry citizens.

Anatoly Chubais defended the second phase of privatization, involving loans by Russian oligarchs to the government in exchange for their eventual capture of state shares in Russian companies, on both economic and political grounds. "Politically, I was in one of the most complicated situations. . .the dilemma was simple—either we will not sell state shares at all or we will sell them via the controversial shares scheme which would bring real money to the Russian budget. Don't forget that with the sale of Norilsk Nickel share, we got the first 170 million dollars. It was absolutely fantastic. It helped the federal budget a lot because the budget situation was critical." Assessing the role of the oligarchs in the evolving political situation, he said: "I strongly believe that the only way of preventing [the Communist leader] Zyuganov from becoming president in 1996 was the creation of big private business in Russia. Their mentality differed from Soviet style management. . . . They fought for improving economic efficiency. . . . That is the economic side of the story. At the same time, they became powerful, wanting to use their power according to their understanding of the political situation. The presidential election of June 1996 raised the question of Yeltsin or Zyuganov, and they [the oligarchs who bankrolled Yeltsin's election] definitely said Yeltsin. However, in the next phase, they thought they ruled the world and could do anything. So there are positive and negative sides to the story."

But Russian voters concentrated on the negative side of the story. Many of them had received little for their vouchers in the first place. They judged the loans-for-shares scheme as a corrupt maneuver to enrich the few, while depriving them of their legitimate share in assets created collectively during the Soviet Communist period.

The privatization program succeeded in moving essentially all of Russia's formerly state-owned economy to the private sector. However, the economic reform program of the Yeltsin team was devoid of an offsetting component to buy out the losers. For example, perhaps a fraction of the cash received from the oligarchs could have been set aside for welfare payments to the poor or pension payments to the elderly. Or perhaps legal titles to the apartments occupied by the worse-off city dwellers could have been turned over to them via a presidential decree. But steps like these did not occur, and so until the departure of the Yeltsin team from the

Russian government in August 1998, the reformers had to face the entrenched Communist opposition in the Duma and eroding public support.

Institution Building and Policy Choices

Among the staggering institutional inadequacies inherited from the Soviet past, I focus here on handicaps relating to monetary and budgetary problems during the period leading to the financial crisis of August 1998.

At the start of the reform period in 1992, the Central Bank of Russia was under the chairmanship of Viktor Gerashchenko, who had also led the central bank during the final years of the Soviet Union. Gerashchenko was once memorably described by Jeffrey Sachs as the "world's worst central banker," and the central bank at this time was neither independent of the legislature nor in sympathy with the Yeltsin team's program. After a couple of interim chairmen, Sergei Dubinin became the chair of the central bank in 1995, a position he held until the ruble collapse in August 1998. Then Gerashchenko returned to chair the central bank, and by mid-2000, it was mired in corruption scandals of having misused IMF funding. Russian budgetary policy was also in a shambles in the early 1990s. The Soviet government had offered automatic subsidies from its budget to loss-making state-owned enterprises, most of them massive monopolies. At the start of the Yeltsin reforms, these subsidies persisted as a result of the time-honored networking ties between party bureaucrats and factory managers. Moreover, budgetary management was hampered by lack of transparent tax rules and rates involving the federal, regional and local hierarchies and by a lack of effective tax collection.

Gaidar's adoption of economic shock therapy in January 1992, combining price decontrol with a ruthless slashing of budgetary support to consumers and producers, aimed to end the practice by which inefficient factory managers were routinely helped out with budgetary support. However, the traditional bailout practice reasserted itself in full force when the central bank, led by Gerashchenko, released money supply to meet managerial demands. Inflation at the end of 1992 ran at 2500 percent. At the same time, the Gaidar plan summarily transferred several entitlement outlays from the federal budget to the regions without matching resources.

"What would you do differently if you had another chance?" I asked Gaidar. Were he to be appointed acting prime minister again, he said that he "would handle a lot of technical issues differently." The technocrat reappeared in full measure: he would push oil price, foreign trade, and exchange rate liberalization faster, issues on which he had evidently "compromised" to placate the opposition. "I would be surer of undertaking the right measures and less ready to make compromises, knowing well the high price one pays later for compromises." The policy shock that he introduced in early 1992 was, in other words, incomplete. A total earthquake was necessary because a limited one involved compromises! In hindsight, Nemtsov too played down the importance of timing or sequencing of reform legislation. "The unfolding of the reform process is not the critical aspect. Absence of political will to undertake reforms is the main problem. The remaining issues are largely technical."

Revamping the tax and pension regimes with a view to improving the budgetary situation and converting the Russian central bank into a nimble policymaking body were clearly uphill tasks. They were hampered not only by the Communist intransigence in the Duma, but also by a declining Russian economy through much of the 1990s. These impediments weakened by the early 2000s. The December 1999 election diminished the presence of the Communists in the Duma, and Russia's economy began to revive based in part on the ruble devaluation and oil exports, which together created a benign environment for institution building at the start of 2000. My interviews with Dubinin and Vyugin, who steered monetary policies during these contrasting scenarios, brought out the acute problems of the former in the 1995–1998 time period and the robust confidence of the latter in the last couple of years.

Dubinin, who succeeded Gerashchenko as central bank chairman in 1995, recalled the policy dilemmas that he faced leading up to the ruble's collapse in August 1998: "The joint decision of the government and the central bank was that we must continue our anti-inflation monetary policy, and move forward on budgetary policy and structural reform. But every year we saw that progress in the latter sphere was missing. The gap became wider and wider. . . . The problem of the budget was lagging tax collection rather than cutting expenditures. . . . And there were a number of mistakes. For example, the government tried to handle the tax situation by trying to push the tax code, a massive document, in the Duma. It required a lot of time, months to get it approved. [It was turned down by the pre-1999 Duma.] We needed changes in the tax system and the appropriate legislation in perhaps two months. The government worked on the tax code rather than on the concrete problems of taxation."

By contrast, Vyugin came across as a policymaker in command of his role in a mid-2003 interview: "The central bank is not seriously concerned about inflation now because inflation expectations are positive. Our expectation is for inflation to steadily come down. People understand that, and expect it to be lower in the foreseeable future." Describing the status of the central bank, he said: "We are independent. We have only one requirement. We must report to the parliament once a year. As far as the government is concerned, the Duma can pass a no-confidence motion. With us, it requires that we report to it once a year."

How did Russia's monetary and fiscal policies make the transition from dysfunction and chaos to marked improvement? The International Monetary Fund figured prominently in this transition.

The IMF in Russia

When the International Monetary Fund stepped into Russia in early 1993, the four-digit inflation rate meant that the pressing concern was to salvage a building in flames, not to redesign its architecture. Thus, issues like asserting control over monetary policy, or adopting rules to clean up the tax regime, or converting the Russian central bank into a model resembling the Federal Reserve, didn't receive much attention. The IMF was a staunch advocate of speedy inflation control buttressed by a strong exchange rate, and an enthusiastic promoter of free capital mobility. Thus, it supported tight monetary policy that kept the central bank discount rate at 25 percent and higher. This policy was combined with an inordinately strong ruble. Finally, foreigners were allowed to buy short-term government bills so that the budget deficit at 7 percent of GDP from 1995–1998 could be contained (Desai, 2000).

This policy mix brought down inflation, which fell to an annual rate of 70 percent by 1995 and to just 3 percent by the end of 1997. But the inordinately strong ruble exchange rate largely destroyed the competitive position of Russian industry on world markets. Also, the combination of extremely high interest rates and single-digit inflation meant that the Russian government and commercial banks went on a borrowing binge fed by speculative inflows that rushed in to earn a real return of 20 percent and more. Russian commercial banks, unsupervised and unconstrained by the central bank, borrowed short-term in foreign exchange markets and invested in government bonds that turned out to be worthless assets a year later. In Russia's institutional setting, the combination of high interest rates, a strong currency and full capital account liberalization led to massive short-term speculative capital flows. The premature opening of Russia's economy to capital inflows was a colossal mistake leading to the Russian government's debt default, the collapse of the ruble and another severe shock to Russia's economy in 1998.

The IMF could have reduced the risks of this outcome in several different ways. After tight monetary policy had succeeded in bringing inflation down to double-digit rates in 1995, it could then have encouraged a more gradualist approach to reducing inflation in the next few years. It could have opted for a selective opening of the economy focused on long-term capital inflows. The IMF could have supported temporary controls on outflows of funds from Russia toward the end of 1997 when foreign holders of government bonds, unnerved by the unfolding Asian financial crisis, went into a selling spree. However, given its policy commitment to free capital flows, that choice would have put the IMF in the role of a clergyman renouncing his faith in the middle of a spiritual crisis. In Russia, the IMF stuck to its one-rule-fits-all-situations policy stance rather than crafting a feasible mix of monetary control, exchange rate management and capital mobility that would have worked with Russia's combination of an out-of-kilter tax regime and dwindling foreign exchange reserves.

Dubinin commented extensively on these issues from his perspective as chairman of Russia's Central Bank from 1995 to 1998. "The top level IMF command team liked Russia. That was helpful. But it applied the same model in Russia as in other countries. For example, it insisted that we open up the market for foreign capital. When we decided to undertake that, it said the opening ought to be full and free without restrictions." He also sized up the Washington policymaking nexus in the following words: “In their assessment of the IMF, the U.S. Congress and the Administration were influenced by political and even personal considerations. For example, it was absolutely clear to everybody that there was tension between the Fund and the Treasury. The Treasury had a concrete role in negotiating a program for Russia. It insisted that our anti-inflation program, tax collection effort and bankruptcy implementation must be more severe.”

While Dubinin and Vyugin assessed the IMF’s policymaking role from a technical perspective, Gaidar put it in a broader political context. In 1990 and 1991, “an enormous powerful empire [the Soviet Union] disintegrated, leading to anarchy in its trail. The existing institutions stopped functioning and new institutions could not be created overnight. . . . But what was the response of the West to the new challenge?. . .Let us imagine just for a minute that the Fund was put in charge of restoring Europe after World War II. . . . It does not have the decision-making process and procedures and human resources to deal with this enormous problem for which you need political leadership rather than technical expertise to resolve. And so everybody is now wondering: why is the Fund not up to the level of the problem?”

In the end, were Yeltsin and his team “up to the level of the problem?” They succeeded in irreversibly planting the powerful *ideas* of democratic choices and free markets in the land of Lenin and Stalin. However, having experienced the inevitable turmoil of this transition, the public, in Gaidar’s words, hankered for order and stability. The election of Vladimir Putin to the presidency in April 2000 was a predictable outcome. So was the resounding emergence of the pro-Kremlin United Russia group in the Duma following the December 2003 parliamentary election. Putin rode to a second, four-year presidency in March 2004 with full freedom to choose a government.

Putin and State Power: How Far Will He Go?

Will a lack of constitutional limits combined with the escalating consolidation of political authority convert Vladimir Putin, a former KGB operative and an avid judo master, into an absolute authoritarian leader? My interviewees expressed their concerns that the Russian constitution of 1993 lacks checks and balances and that Putin believes in markets but not in democracy. These concerns were heightened by Putin’s proposals announced on September 13, 2004, in the aftermath of the Beslan terrorist attack, that governors be nominated by the president for subsequent approval by the regional legislatures, rather than elected by voters, and that Duma members be elected solely on the basis of proportional votes garnered by party-list contestants, to the exclusion of single-mandate constituencies.

Russia’s missing checks and balances were summed up by Rogov: “We adopted a constitution toward the end of 1993 which gave enormous authority to the executive without appropriate checks and balances. The legislative branch is weak and is dominated by the executive authority. The judiciary is not independent

. . . . Yeltsin abandoned the notion of checks and balances, and created a democracy for the bureaucracy and operated by the bureaucracy." In particular, the constitution has a loophole allowing the executive to adopt critical measures via presidential decrees and government resolutions without involving the legislature. For example, many decisions relating to asset privatization under Yeltsin were pushed in this manner by Chubais with unusual speed and timing, occasional secrecy and "dizzy with success" fervor, earning him the title of a "neo-Bolshevik."[3] When the pro-Putin group, United Russia, gained majority power in the Duma in 2003, it effectively gave the executive initiative and control over the legislative process and government formation. In Yavlinsky's assessment, the Russian government "is a technical department of the Kremlin. It is not a political institution."

According to Nemtsov, Putin believes that Russia needs a healthy market economy, but "unfortunately he doesn't believe that Russia needs a democracy too. It is difficult to explain to someone with a KGB background that there is a connection between democracy and competitive markets. This is the real difference between Putin and Yeltsin. Yeltsin believed in this connection in his very soul, especially after he visited the U.S. and went to an American supermarket. 'I am for democracy and I am for private business,' he said. He kept that pledge to the end of his career." As early as April 2000, around the time of Putin's first election victory as president, Gaidar also emphasized this disconnect: "He does not have a good record in the field of democratic freedoms. . . . But he has been clearest on his commitment to the protection of private property and his strong opposition to renationalization."

Putin's first term as president from 2000 to 2004 combined economic liberalization with constraints on democracy. For example, Putin's government successfully steered measures through the Duma relating to the adoption of a tax code (a uniform personal tax rate at 13 percent and corporate tax rate lowering from 34 to 24 percent), a land transactions bill, a criminal code and joint stock company law. It also oversaw the conversion of the upper house of the parliament, composed originally of elected governors, into a rubber-stamping body of presidential appointees; the politically motivated jailing of the oil tycoon Mikhail Khodorkovsky; the installation of Kremlin-vetted appointees in seven sectors of Russia with a view to making regional laws conform to federal norms; and media restrictions on the eve of the December 1999 Duma election. These illiberal political measures are now being supplemented by the post-Beslan proposals.

The Pace of Market Reforms and Political Consolidation at the Center

Yeltsin's leading reformers, Gaider and Nemtsov, argued that with political tightening, the pace of economic reforms had slackened. According to Gaidar (in his October 2004 interview), "Between 2000 and 2002, President Putin introduced

[3] "Dizzy with success" is a phrase with strong connotations for Russians, because it was Stalin's description of his overzealous Bolshevik commissars who got carried away in their program of collectivizing Russia's privatized farms in the early 1930s.

a series of important economic reforms. Unfortunately, the events of 2003 and 2004 suggest that . . . economic reforms have slowed down just as the consolidation of political power has increased." Nemstov supported this position by emphasizing that "reforms of the Russian pension system and restructuring of the energy complex have stopped. . . . Consolidation of power under Putin only cements the role of the corrupt Russian bureaucracy." By contrast, Jordan (in an October 2004 interview) argued that Putin needed tighter political control to limit bureaucratic corruption: "I am not sure that Putin views the consolidation of political power as necessary for promoting economic reform. I think he views the consolidation of control over his own bureaucracy as vital to promoting economic reforms. In fact, short of abolishing interventionist bureaucrats, control over bureaucracy is vital for enforcing any policy whatsoever. The president's lack of control of the bureaucracy, by the way, is another reason why this president can never become a Stalin even if he wanted to. The ground under the president is very soft—wherever he steps, it gives way under corruption."

The challenges of economic reform facing Putin and his government during his second presidential term remain complex and have become even more demanding. True, Russia's economy has been quite healthy from 2001 to 2004: growth has been a steady annual 6 to 7 percent; the budget is in surplus; inflation is in low double-digit numbers; and the Russian central bank has foreign exchange reserves to the tune of $100 billion. But Russia's per capita GDP is only about one-quarter that of the United States. Thirty million Russians, or roughly 20 percent of the population, are poor even by Russian standards. But continued economic growth seems likely to require head-on engagement with several powerful lobbies, including the entrenched bureaucracy, big businesses and the military.

With regard to bureaucracy, Yavlinsky exhibited a chart with a Byzantine maze of over 40 regulatory agencies that must be cleared by Russia's small and medium units before they can set up shop. The number of small businesses employing no more than 100 workers had risen by 10 percent in the last year to 946,000 by September 2004. However, businesses of this size generated only 10 to 12 percent of Russian GDP (in contrast to 50 to 60 percent in developed market economies) and provided employment to 19 percent of the workforce (in contrast to almost 70 percent in some European economies). At the same time, Russian bureaucracy had grown unabated in the past decade from about 1.0 million in 1994 to 1.26 million in 2004. A federal commission ruled that as many as 4,000 of the 5,300 activities of the federal government were essential. The new government formed in April 2004 slashed the number of federal ministries from 24 to 14, but many of them were absorbed as committees in the new structure. According to Nemtsov and Rogov, eliminating the control of bureaucrats on economic decision making will test the new government's commitment to generating growth and employment via small businesses.

Russian big business, especially in the energy and metals sectors, poses another major impediment. A mere 23 businesses control one-third of output and one-sixth of employment in Russian industry (as discussed by Guriev and Rachinsky in this symposium). This concentration of ownership threatens the tax authority's ability to raise revenue and the judiciary's clout in handling corporate misdeeds. Until antimonopoly and antitrust laws are successfully implemented, Russian big business will continue to exercise inordinate political influence.

Finally, Russian policymakers are bent on improving the pay and technology of their military, but divisions exist as to how this should be done. Nemtsov pointed out the difference between the plan for military overhaul proposed by the reformist group, Union of Right Forces (SPS) which he led, and the alternative, Soviet-style changes favored by the generals: "Putin supports the top-level military bureaucracy by wanting to retain its privileged position in the military and combining it with Soviet-style military service at the lower, non-officer level. The recruits must serve for two years with an additional year thrown in. . . .We in the SPS believe that the armed forces must be absolutely voluntary, and must be paid well from the bottom up. The financial problems of higher pay scales [for the soldiers]. . .can be managed." These decisions will affect both the government budget situation and a prospective labor market alternative for young men.

The Transition to a Liberal Political Order: What Prospects?

My interviewees suggested that Russia's progress toward a liberal political order will sometimes continue to appear endangered, certainly by the standards that apply to an advanced liberal order of the American or European variety.

Rogov was most articulate on the need for an appropriate viewing of the unfolding political order in Russia in relation to its progression in the United States: "Of course, we have limited experience with democracy. For a millennium or more, Russia was an autocratic country with imperial authority or Soviet-style ideology. . . . And we must not make the mistake of thinking that the West was always democratic. If you take the U.S., women were given voting rights only eighty years ago. When I first went to the United States thirty years ago as a post-graduate student, I could see 'for blacks only' signs on benches and buses in the South. . . . U.S. democracy in the 1950s was different from what it is in the 1990s. . . . I think that democracy will take longer here to mature than I would like."

Following the Beslan tragedy, I asked my Russian interviewees late in 2004 for their views on whether Putin's proposed measures were necessary for fighting terrorism and how those proposals might affect Russia's fledgling democracy. Nemtsov was most forthright on the issue: "The mistaken policies in the Caucasus, in particular in Chechnya, have created the terrorism issue in Russia. It is absolutely necessary to solve the problem via political means. If media censorship were stopped, the Russian public could begin discussing the issue openly." Nemtsov also argued that having election to the Duma based only on proportional representation along party lines would not jump-start a multiparty system in Russia because "financial resources for party formation are monopolized by the Kremlin; the electronic media is censored; the prospective parties therefore will be loyal to the Kremlin. It will destroy opposition because single-mandate deputies are more independent and critical of government policies. Again, the cancellation of gubernatorial elections violates the letter and spirit of the Constitution. Governors appointed by the president will convert it into a unitary system. Regional autonomy will disappear." At the same time, Nemtsov emphasized that Russia does not have to copy the norms of the American model. "Russia has a totally different history. The government structure should reflect Russia's specific features. We must however live by the Russian Constitution, its division of powers along the federal hierarchy, the free press, and political competition. These basic principles enshrined in the Constitution of 1993 should be protected."

Dubinin saw a need for strengthening state authority, but insisted that such authority should be consolidated not only "vertically" but also "horizontally." "We need an independent judiciary, democratically elected municipal and regional administrations with adequate powers and responsibilities. The latest proposals will lead to the president boldly taking upon himself the responsibility for the appointment of governors and their future decision making. Boldness is a solid characteristic of our president. But in my view, these steps represent a faulty orientation."

While acknowledging the nascent beginnings of Russian democracy, Gaidar reacted to the proposals with the force of his experience in government and as a Duma deputy. Commenting on Putin's announcement to switch to proportional, party-based election of Duma deputies, he said: "Currently there is a small but active group of independent members in the Duma. . . .They constitute members of important Duma committees and Duma plenary sessions. Their positions have limited influence on the decisions but their voice is heard. It influences public opinion. With the implementation of presidential proposals, such people will disappear. Party loyalists will take over. This, in my view, is dangerous." He also viewed the presidential selection of regional governors with alarm. "Russia was ruled like that for several centuries. It did not conquer corruption. The final decades of the czarist regime also showed that it did not stop terrorist activities. Moreover, it did not prevent two revolutions, namely the crash of the czarist regime [in 1917] and the disappearance of the Soviet Union [in 1991]. True, Russian voters under conditions of Russia's nascent and unstable democracy are unable to elect the most qualified regional governors but gradually with accumulated experience they will understand that the residents of the regions themselves rather than the president in Moscow will resolve local problems." Overall, Gaidar compared the evolving political arrangements in Russia to the one-party system under the Revolutionary Party in Mexico and to conditions in Italy and Japan between the end of the Second World War and the 1980s.

While lamenting that the pace of economic reform had slowed, Gaidar remains optimistic about the progress already achieved. "The Russian public and Russian elite agree that free market arrangements will prevail in Russia. Opinions differ on the limits of the process rather than on the inevitability of market prices, a convertible currency, and private property. On the other hand, the outcome of the struggle for a functioning and stable democracy is not clear. But from a long-run perspective, I do not believe in the emergence of non-democratic regimes in countries with educated, urban populations."

In managing the end of Soviet Communism, the Yeltsin team went up in flames. But despite the consolidating impetus under Putin, its liberal legacy will ultimately prevail.

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