Why Has Russia's Economic Transformation Been So Arduous?

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Abstract

This paper examines the problems of Russia's post-communist economic transformation. Its main thesis is that the Russian attempt at radical economic reform largely failed, because of extraordinary rent-seeking by old enterprise managers through export rents, subsidized credits, import subsidies and direct government subsidies, while they gained little from privatization. The reason why the managers were so strong was that the Soviet Union left large economic distortions behind and a virtually unconstrained economic elite. The reforms could have been reinforced if democratic institutions had been developed faster, or if the West had provided financial support for the reforms in early 1992. Over time, rents have dwindled, but Russian institutions have been seriously damaged by corruption. Intense competition over rents contributed to the financial crash in August 1998, but the competition also limits the rents, and might ease the way for future reforms.

During the last decade, Russia's GDP has fallen by about 40 percent, and GDP is likely to fall by several percent in 1999. In parallel, Russia has seen an extraordinary increase in income differentials and poverty. For long, unemployment was limited, but recently it now exceeds 12 percent. Why did these negative developments occur?[1]

Many have argued that its reforms have been too fast and radical, criticizing "shock therapy", "neo-liberalism", monetarism and privatization. However, Russia's financial collapse in August 1998 made obvious that the reforms have neither been radical nor fast, but slow and partial. The Russian state remains large and pervasive. All liberalization indices show that the Russian economy is far from liberal, and corruption thrives on excessive regulations. As President Yeltsin (1999) put it in his Annual Address to the Federal Assembly on March 30, 1999: "We have gotten stuck half-way in our transition from the planned and command economy to a normal market economy. We have created … a hybrid of the two systems."

Russia's key problem has been that a few people got very rich on the partial reforms, and they have bought a large part of Russia's politics – politicians and officials. To preserve their rents, the newly-rich use their economic power to prevent liberal economic reforms, which could provide Russia with economic growth and welfare. Russia's post-communist period has been characterized by a struggle between reform and rent-seeking. Unfortunately, the reformers mostly lost. Joel Hellman (1998) has summarized this consequence of partial reform as "Winners Take All". Andrei Shleifer and Robert W. Vishny (1998) call these government pathologies "the grabbing hand".

Rents are usually understood to be money made on government transfers or any kind of

[1] This paper draws on previous work with Peter Boone, Mikhail Dmitriev, and Simon Johnson, to whom I want to

market distortions. The issue in this paper is free money for the elite, made either on direct government subsidies or indirectly on government regulations. However, considering the peculiarities of post-communist transformation, I shall also include resources that are free in the sense not safeguarded by the rule of law, while I exclude social transfers and government financing for genuinely social purposes, even if some of that might be considered rents as well. Rents are understood as flows. The opposite of rents is profits earned on a competitive market.

In this paper, I review Russia's recent economic history from the perspective of rent-seeking. Initially, we need to consider Russia's preconditions for reform. Second, to show the interconnection between macroeconomic stabilization, liberalization and privatization, I discuss their evolution in three periods. During the attempt at radical economic reform from 1991 to 1993, actual reforms were slow and partial, leading to extraordinary rent-seeking through subsidized credits and arbitrage in foreign trade. From 1994 to 1995, reforms proceeded and rents as well as inflation were brought under control. However, from 1996 to 1998 reform stagnated, as the rent-seekers made a comeback, blocking further reforms, which prompted the financial crisis in the summer of 1998. A fifth section sums up the development and politics of rent-seeking, and a sixth section considers alternative policies.

Legacies of the Soviet Union

A key feature of the Soviet system was the Nomenklatura system. A tiny elite controlled all decision-making and resources (Voslenskii 1984). In the 1980s, senior bureaucrats were no longer afraid of the supreme leader. They implemented orders that benefited them directly, ignoring commands contradicting their interests. The demise of the Soviet system was facilitated

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by a division within the Nomenklatura. Its economically-oriented members, primarily state enterprise managers but also some officials and politicians, thrived on the inconsistencies of the collapsing socialist system. They wanted the freedom of the market for themselves but regulations for others. These “red directors” were already well organized, primarily in the Russian Union of Industrialists and Entrepreneurs and the Russian Association of Banks. By opting out of the socialist system for a partial market economy, the red directors left the Soviet elite split and politically vulnerable. When the Soviet Union collapsed a country, a political system, and an economic system disintegrated, leading to general confusion. Serious economic imbalances and distortions contributed to its fall. Some conditions were of great importance for the future attempts at market economic transformation (Åslund 1991).

First, Soviet finances collapsed in 1991, as the union republics stopped sending tax revenues to Moscow. The Soviet government faced a huge budget deficit, while international financing dried up, since the Soviet Union defaulted on its foreign payments. In late 1991, the central Soviet government lived on little but the emission of money.

Second, the union republics started issuing their own ruble credits without any coordination with the Soviet State Bank. The more Soviet ruble credits any republic issued, the larger share of the common Soviet GDP it obtained. This competitive issuance of one currency virtually guaranteed hyperinflation.

A third legacy was the idiosyncratic regulation of most prices, leading to greatly distorted prices. The combination of external default and partial liberalization made the market exchange rate fall like a stone in 1991, which aggravated the distortion of relative prices. Commodity prices were minimal, while industrial consumer goods were overpriced. In December 1991, the Russian state-controlled price of crude oil was 50 cents a ton, that is 0.4 percent of the world market price

(Delpla 1993).

Fourth, a partial liberalization of prices and foreign trade aggravated economic distortions. The Soviet Union had one special exchange rate for every major good, and the differences between them were large. During Soviet President Mikhail Gorbachev's gradual economic reforms, an increasing number of Soviet enterprises received foreign trade rights. In 1988, 213 enterprises had foreign trade rights, and in 1990 their number approached 20,000 (Åslund 1991). With the right connections, such enterprises could acquire oil or metals at low Soviet state prices, obtain export licenses and quotas from the foreign trade authorities, and sell the commodities abroad at high world prices.

A sixth peculiarity was the effective legalization of management theft in 1988 through the adoption of the Law on Cooperatives. It allowed managers of state enterprises to establish private enterprises, which undertook arbitrage with the state enterprises they were managing, transferring the profit of state enterprises to management-owned private enterprises. Commercial banks became the most prominent new free-wheeling cooperatives.

Russia at the end of communism is often described as an institutional vacuum, but that is not quite true. The red directors thrived on institutional anomalies and economic policies incompatible with a market economy, such as unrestricted monetary emission, low interest rates, distorted relative prices, multiple exchange rates, rigorous licensing of entrepreneurship, and myriad regulations. Little but banking was free. Massive rent-seeking was going on and it would naturally lead to partial reforms.

Russia's preconditions for reform in 1991 greatly differed from those of China at any time. First of all, unlike China the Soviet Union suffered a multiple collapse, offering no room for a gradual approach. Second, piecemeal reforms had repeatedly been reversed in the Soviet Union, leading to the widely-held conclusion that the Soviet political and economic system was so petrified, that only a wholesale transformation was possible, while gradual reform had proved possible in China (Kornai 1992). Arguably, Soviet power was so dissipated that there was hardly any central policy-making power left in the Soviet Union, while China had some. Third, the structural differences in the economies were enormous, as China was still dominated by agriculture (Sachs and Woo 1994). The differences between Russia and China are so great that there is little reason to assume that similar policies would be optimal or even possible.

An Attempt At Radical Economic Reform, 1991-1993

In the fall of 1991, Russia was in total disarray. All monetary and fiscal discipline had faded away, while prices were largely regulated, leaving many shops virtually empty. People had little or no reason to work. In this dire state, Russia started its transition from the Soviet economic system towards a market economy. On the one hand, extraordinary rent-seeking prevailed at the time. On the other hand, Russia was subject to multiple shocks: external default, a collapse in state revenues, plummeting foreign trade, and a change of political regime. These shocks opened a window of opportunity for fundamental systemic change.

The first step towards profound change was the election of Boris Yeltsin as Russian President with a popular majority on June 12, 1991. After the abortive communist coup in August 1991, he obtained actual executive power. On October 28, President Yeltsin took a second step, by declaring his intention to undertake a radical market economic reform in a speech to the Russian Congress of People’s Deputies (Yeltsin 1991). A third step was that an overwhelming majority of the Congress adopted his speech as a guideline for the government’s economic policies by a few days later. A fourth step came a week later, when Yeltsin appointed a new type of government. Almost all old Soviet branch ministries were abolished, and most ministers were outsiders – young liberal economists, led by Yegor Gaidar. Only a handful of old branch ministries persisted (Industry, Transportation, Domestic Trade, and Foreign Trade). President Yeltsin and his reform ministers declared their intention to build a normal market economy in Russia as fast as possible.

The reformers focused on getting state finances under control and drew up a balanced budget for the first quarter of 1992. Another priority was to liberalize the economy – prices, domestic trade, foreign trade and entrepreneurship. Most prices and imports were liberalized, eliminating large price subsidies from the budget. The reformers slashed arms procurement by no less than 70 percent.

Five central struggles on deregulation and macroeconomic stability occurred in this period. One concerned the regulation of commodity prices and their exports. The second battle involved the money emission. A third related issue was the preservation of the ruble zone. A fourth headache was import subsidies, and a fifth concern was the freedom of enterprise (Åslund 1995).

Under the leadership of Deputy Prime Minister Yegor Gaidar, the reformers endeavored to liberalize Russia's commodity prices and exports in early 1992, but the anticipated liberalization was repeatedly delayed, as the energy lobby resisted ferociously and won. The managers of the state oil companies argued that Russia's industry would collapse if it faced world market prices, and they were supported by the communists. The energy lobby was headed by Viktor Chernomyrdin, who replaced Gaidar's liberal minister of energy in May 1992 and Gaidar himself in December 1992. In the spring of 1992, the state price of oil was still one percent of the world market price. Even in 1993, the average Russian oil price was only 8.3 percent of the world market price (Delpla 1993). Managers of state companies producing oil and metals bought these commodities at the fixed state prices from "their" state enterprises through their private trading firms. They acquired export quotas and licenses through connections in the foreign trade administration and sold abroad at the world market price. The total export rents were no less than $24 billion in the peak year of 1992, or 30 percent of GDP, as the exchange rate was very low that year.[2] The resulting private revenues were accumulated abroad, which led to a corresponding capital flight. The beneficiaries were a small number of state enterprise managers, government officials, politicians and commodity traders.

Second, a massive competitive emission of money had started in 1991. The reformers failed to get control over the Central Bank, which was supervised by the old semi-democratic Russian parliament, the Supreme Soviet. In 1992, its speaker, Ruslan Khasbulatov, pressed hard for cheap credits and triumphed (Matyukhin 1993). The Central Bank issued enormous credits at the subsidized rates of 10 or 25 percent a year, while inflation was 2,500 percent in 1992. A credit from the Central Bank was simply a gift. In 1992 alone, the net credit issue of the Central Bank of Russia was no less than 31.6 percent of GDP (Granville 1995a, p. 67) Of these, directed credits to enterprises, which were tantamount to subsidies, amounted to 23.0 percent of GDP (IMF 1993, p. 139). While these fortunes were less concentrated than the benefits from commodity exports, they made many Russian bankers rich.

A third concern was the persistence of the ruble zone, which rendered financial stabilization virtually impossible in all the member countries (Sachs and Lipton 1993; Hansson 1993). Many interests supported it. In Russia, the red directors wanted to continue "selling"

[2] In 1992, more than 70 percent of Russia's exports were subject to export quotas (Aven 1994, p. 84) Total Russian exports outside of the CIS amounted to $42.2 billion (Goskomstat, 1994, p. 3). The average domestic price of these regulated export commodities was at most 10 percent of the world market price, and collected export tariffs amounted to some $2.4 billion, while GDP was only $79 billion in 1992 because of the very low exchange rate (World Bank, 1996b).

unsaleable goods to the former Soviet republics, at the expense of Russian government credits. Commodity traders exploited the differences in price regulation between various former Soviet republics. The old establishment in other former Soviet republics thrived on cheap Russian credits. The cost to Russia was huge. The IMF (1994, p. 25) has calculated that in 1992 it cost Russia 9.3 percent of GDP in financing and 13.2 percent of GDP in implicit trade subsidies, amounting to a total cost to Russia of 22.5 percent of GDP. Russia could not afford these subsidies, which even exceeded Russia's budget deficit. Strangely, the IMF supported the ruble zone against the Russian reformers. Only with the currency reform in Kyrgyzstan in May 1993, did the IMF take a clear stand against the ruble zone. In the course of the next two years, financial stabilization took root in one country after the other.

A fourth important struggle involved import subsidies. In the winter of 1991-92, fear was great that the country would suffer famine. Therefore, the reformers had no chance to abolish the existing import subsidies for food. A food importer paid only one percent of the going exchange rate, when he imported essential foods, but he could resell them relatively freely on the domestic market, pocketing the subsidy himself. These imports were paid for with western "humanitarian" export credits, which were added to Russia's state debt. The total cost was 17.5 percent of Russia's GDP in 1992 (IMF 1993, pp. 133, 139). These revenues were highly concentrated to a limited number of traders in Moscow, operating through the old state agricultural monopoly companies.

A fifth battle was fought over the liberalization of entrepreneurship. In January 1992, President Yeltsin issued a decree allowing anybody to trade anywhere at any time with anything at any price. This decree was modeled on Finance Minister Leszek Balcerowicz's successful deregulation in Poland. The public response was extraordinary. In no time, tens of thousands of people took to the streets and started trading all over Russia. However, the established traders opposed the competition, and they solicited support from the mayors in the big cities. In April Moscow Mayor Yuri Luzhkov prohibited this trade, and the police became preoccupied chasing street traders away. Other mayors followed suit and successfully eliminated the freedom of enterprise. In May 1993, a law on comprehensive licensing of virtually all economic activities was adopted.

The simple truth is that reformers dominated the Russian government only from November 1991 until June 1992. They tried to undertake radical reforms, but by June 1992 they were thoroughly beaten by a big business community of bankers and industrialists in cohort with the old parliament. In the fall, Russia was close to hyperinflation. The rent-seekers – state enterprise managers, bankers, corrupt officials and commodity traders – were organized and politically influential, while they faced little counterweight. They amassed huge fortunes, swiftly moving Russia from an average European income differentiation to one of Latin American heights (Milanovic 1998). These rents were derived either directly from government subsidies or indirectly from government regulations. If commodity prices, exports and imports had been deregulated in 1992, and if market interest rates had been allowed to prevail, these fortunes would never have been generated. Then, enterprises in Russia would have been forced to restructure to survive, as in Poland or Estonia.

De Melo and others (1997) have shown with regressions that the worse the initial conditions for reform were, the more likely a country was to fail. However, some countries undertook radical reforms in spite of adverse preconditions, and they have got the greatest positive effects, namely, the Baltic states, Georgia and Kyrgyzstan. The two latter countries had growth rates of 11 and 10 percent, respectively, in 1997.

In 1993, however, the reformers in the government made amazing headway. The dysfunctional ruble zone was broken up, and each of the former Soviet republics established its own national currency by late 1993 (Granville 1995b). Subsidized credits were abolished in late September 1993 with a simple government decree, and by November 1993 Russia had positive real interest rates. At the end of 1993, the exchange rate was fully unified, eliminating the last import subsidies. In parallel, the privatization of small enterprises was successfully undertaken, and large-scale privatization was under way. The economic costs had been great because of both the huge rent-seeking and necessary adjustment costs, but in late 1993 the reformers had accomplished so much that the reforms appeared irreversible.

How could these fundamental reforms be undertaken in late 1993, when they had seemed impossible in the spring of 1992? There were many explanations (Åslund, Boone, and Johnson 1996). Several rents declined over time for reasons beyond the control of politics. As people and enterprises learned not to hold money in any form, the velocity of money rose, and monetization fell, which reduced the inflation tax sharply. Therefore, the budget deficit could no longer be financed with the emission of credits. Similarly, the extreme price distortions and the very low exchange rate were done away with by an awakening market. Moreover, people learned what a market economy was, and their tolerance of unjustified subsidies withered, as critical media exposed various forms of rent-seeking. In 1992, managers called in chorus for more and cheaper credits, but when subsidized credits were abolished, hardly anybody demanded their return. The same was true of the import subsidies. In the referendum in April 1993, a majority of the Russian voters expressed support for radical economic reforms, giving the reformers a new breath. Most of these changes were conditions in a first real Russian stand-by agreement with the IMF, and the reformers utilized the IMF agreement to push through their own demands. Moreover, the dissolution of the Congress of People's Deputies in September 1993 created a temporary political vacuum that offered both reformers and rent-seekers uncommon opportunities. The abolition of subsidized credits and the unification of the exchange rate were institutional changes that were locked in. However, the reformers suffered a set-back in the parliamentary elections in December 1993, forcing the departure of reformist Deputy Prime Ministers Yegor Gaidar and Boris Fedorov. Anatoly Chubais stayed as a single reformist Deputy Prime Minister in charge of privatization.

Inflation Was Defeated, But Its Structural Causes Persisted, 1994-95

The exit of all reformers but Chubais from the government led to a widespread expectation of a reversal of the reform policies, especially as the new government was composed of industrial lobbies, lobbying for privileges for their favorite enterprises. However, little happened to economic policy in 1994.

Prime Minister Chernomyrdin secured extraordinary monopoly rights for his creation, the natural gas monopoly company Gazprom, granting it extensive tax exemptions at the end of 1993. The value of these tax exemptions amounted to 1-2 percent of GDP.[3] First Deputy Prime Minister Oleg Soskovets secured tax exemptions for the metallurgical industry, whose value amounted to about 2 percent of GDP.[4] Soskovets also supported the National Sports Fund, which got the right to import alcohol and tobacco tax free. It soon became the leading importer of these goods to Russia. The value of this tax exemption was estimated at as much as $10 billion or about 3 percent of GDP (Bagrov 1999).

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[3] Gazprom contributes about 8 percent of GDP in net value added.

[4] The main trick was t o exempt "tolling" from VAT and foreign trade taxes. Metallurgical enterprises bought inputs on the world market for a higher price than the ruling market price and sold them at a lower price, leaving

Domestic commodity prices had been liberalized in 1993, but to little effect, since the commodity lobbies kept domestic prices down through quantitative export controls. The World Bank and the IMF fought hard against the export controls. In July 1994, all export quotas apart from those for oil were abolished, and in January 1995 also the export quotas for oil were abandoned (Bagrov 1999). Yet, by rationing the export volumes through the pipeline system, the oil managers succeeded in keeping the domestic oil price artificially low. Even so, by 1995 the export rents had been reduced to just a few percent of GDP.

Even so, the budget balance was gradually undermined, and on "Black Tuesday" October 11, 1994, the exchange rate of the ruble fell precipitously by 27 percent. The exchange rate had assumed a real economic meaning, and powerful economic interests had gotten used to a reasonably stable and predictable exchange rate. Hence, this mismanagement – or probably manipulation – aroused a popular outcry. The main beneficiaries of a low exchange rate, the commodity traders, were no longer the dominant force in Russian business, as their rents were drying up. The leading economic policy-makers – apart from Chernomyrdin – were sacked by President Yeltsin, and Chubais was put in charge of macroeconomic policy as First Deputy Prime Minister.

In the spring of 1995 macroeconomic stabilization was finally put on track. Russia concluded its first full-fledged stand-by agreement with the IMF, with more than $6 billion in financing in one year. The government reduced the general government deficit from 10.4 percent of GDP in 1994 to 5.7 percent of GDP in 1995, although revenues fell by 3.6 percent of GDP. The government's trick was to cut enterprise subsidies by no less than 7.1 percent of GDP and regional transfers by 2.5 percent of GDP, while socially important expenditures were maintained

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the profit in a trading company registered in a tax haven.

(see table 1). With strong IMF support in the government, Chubais won over Soskovets within the government over the elimination of the tax exemption for the National Sport Foundation, but the parliament prolonged it until the summer of 1995 (Bagrov 1999). By the summer of 1996, financial stabilization had been attained. Inflation dropped to 22 percent in 1996 and to 11 percent in 1997.

It is curious that it was possible to undertake a financial stabilization, by cutting subsidies, when the government was dominated by industrial lobbies. The causality is not obvious, and the explanations are many. First, the underlying reason was that the old rents were minimal. Subsidized credits and import subsidies were gone, and export rents were small. The sharp cut in subsidies made it at long last credible that profit-seeking would become more profitable than rent-seeking in Russia. Second, at long last the Russian government and the Central Bank pursued a coordinated economic policy, aiming at macroeconomic stabilization. Third, for the first time, the IMF was considering substantial credits, and its stand-by loan in 1995 amounted to 2 percent of GDP, which gave the IMF real political weight. Admittedly, on April 1, 1992, US President George Bush and German Federal Chancellor Helmut Kohl had declared their intent to mobilize a Western aid package of $24 billion for Russia, but this claim was never substantiated or rendered credible. Fourth, the immediate cause was the currency crisis of October 1994, which greatly upset the Russian elite and created a political momentum for reform. Fifth, the reformers in the government fought better than ever. Their method was to hit all important interest groups at the same time rather than offering them any trade off. Enterprise subsidies and regional transfers were cut by two thirds. For those who lived on budget subsidies, this felt like shock therapy. Finally, Gaidar's party Russia's Choice was actually the largest parliamentary faction, providing the reformers with a good base in the State Duma.

This was an extraordinary blow to all rent-seeking interest groups, and rather than rising to fight, the sudden reduction in subsidies left them in disarray left them humbled, illustrating that the smaller their rents the less their political power. Financial stabilization divided the Association of Russian Banks. When the inter-bank market dried up in the fall of 1995, financially strong banks did not call for any state support but tacitly favored bankruptcy of their competitors. At the same time, a new generation of private bankers took over from the old state bankers, facilitating but not necessitating a change (Dmitriev, and others 1996). Similarly, the old red directors lost ground to new businessmen. This is how shock therapy reforms should work. By changing the paradigm and the rules of the game, it entices some businessmen to opt for profits on competitive markets instead of rents, thus breaking up the rent-seeking lobbies.

Andrei Shleifer and Daniel Treisman (Treisman 1998a; Schleifer and Treisman 1998) have presented an alternative explanation. They argue that many bankers were enticed by a new rent in the form of excessive yields on treasury bills, turning the interest of the bankers from inflation to low inflation and a reasonably steady exchange rate. Meanwhile loss-making enterprises started living on non-payments instead of budget subsidies. Non-payments were in fact subsidies but they did not boost inflation. They conclude that the Russian reformers used a less inflationary form of rent to lure the winners from inflationary partial reform into giving up their previous inflationary rents. Others have seen the loans-for-share privatizations in late 1995 as a government pay-off to new businessmen.

I have several problems with this explanation. First, it appears a rationalization in hindsight. In early 1995, the reformers did all the right things, driving down rents, which divided the business community. Much later, only at the end of 1995, did new rents mount. They were not part of the stabilization deal of March 1995 but a reaction in anticipation of the reformers in the

December 1995 parliamentary elections. Second, the Shleifer-Treisman cure did not work. No lasting improvement was accomplished. The yields on the treasury bills were reasonable only temporarily in 1997, and they were the direct cause of the financial crash in 1998. Therefore, such a strategy would only have been a foolhardy postponement of a crisis. Third, successful reforms, notably in Poland and Estonia, have beaten the rent-seekers by changing the rules of the game one and for all enticing businessmen to opt for profits rather than offering them new forms of rents. Fourth, the very purpose of reform is to defeat rent-seeking and establish a more productive set of incentives. It would be both illogical and defeatist to think that people can only become honest if they are bribed. It seems more plausible that rents were driven down below a critical threshold and the reforms were rendered credible so that a sufficient share of the business community decided to opt for profits instead of rents.

Barry Ickes and Clifford Gaddy (1998) have analyzed barter and off-sets as means of hiding the economic reality, providing big enterprises with tax exemptions or subsidies. However, they see these devises as defensive mechanisms of enterprises that resist change and argue that it is extremely difficult to change anything in the Russian economy. That rings more true.

The other big economic event of 1994-95 was the completion of the privatization of large and medium-sized enterprises through vouchers. Altogether nearly 18,000 large and medium-sized enterprises were privatized. Officially, over 70 percent of the economy—measured as a share of GDP or employment—now belongs to the non-state sector. Many complaints have been raised about privatization. One is that the old management has acquired too much ownership. Inquiries show, however, that only 18 percent of the shares of the privatized large and medium-sized enterprises belonged to the old managers in 1996 (Blasi, Kroumova, and Kruse 1997, p. 193). As state managers virtually owned the public enterprises before privatization, this implies a considerable reduction of their ownership. Considering the distribution of power in Russian society, this appears an extraordinary success.

Another concern has been that enterprise restructuring has been too limited. Yet, of large and medium-size enterprises, 33 percent changed management between 1992 and 1996, and about one quarter of Russia's large and medium-sized enterprises had gone through substantial enterprise restructuring (Blasi, Kroumova, and Kruse 1997, 203). Annette Brown and David Brown (1999) have analyzed the Russian Enterprise Registry Longitudinal Database of about 30,000 large and medium-sized industrial enterprises. They find that Russian industrial structure is undergoing dramatic changes. The size distribution of enterprises is converging to that found in the US, and their sizes are becoming more varied. Many new small firms enter and poor enterprises actually risk being closed down. There is a high turnover in market leadership. Competition is evident and has positive effects. A World Bank enterprise survey found that real sales per worker increased by 12 percent a year from 1995 to 1997, though the increase was to a large extent accomplished through labor shedding (Djankov 1999). The problem is hardly privatization but that private property rights remain limited, because of intrusive state regulation, as local authorities harass entrepreneurs with arbitrary taxation and numerous inspections. Moreover, the ownership of land remains restricted.

A third complaint is that privatization has led to a concentration of wealth. Almost all Russia's biggest companies have been freely traded on an open stock market, and the total market capitalization has vacillated between 5 and 20 percent of GDP from 1996 to 1999. That is, the market value state enterprise managers got from the voucher privatization of their enterprises was only between 1-4 percent of GDP in total, to compare with 81 percent of GDP through export rents, import subsidies, subsidized credits and direct subsidies in 1992. Moreover, privatization did not facilitate but complicated management theft. Thus, the concentration of wealth was not caused by privatization, but by other forms of rent-seeking. Popular rage was probably aroused because privatization was the only open and transparent form of transfer of wealth, while the far larger financial flows were covert. People tend to overestimate the value of huge smoke-stacks. Few noticed that the oil managers had become tremendously wealthy before privatization, which they actually resisted, or that bankers used their wealth already created from subsidized credits and commodity trade to buy enterprises, on which they largely lost money. Politically, these popular misperceptions have been extremely harmful. Besides, to facilitate privatization politically, the reformers had unwisely boosted popular expectations of gains from privatization to an unrealistic level, which aroused disappointment. Few realized that old Soviet enterprises are of little or no value, and people suspected that somebody else had taken their share.

A fourth criticism concerns a special “loans-for-shares scheme”, which was introduced in 1995 for the privatization of a limited number of very large enterprises. The movers behind this scheme were not “red directors,” but some of the new bankers, notably Vladimir Potanin of Oneximbank and Mikhail Khodarkovsky of Bank Menatep. The government’s dilemma was that too many large enterprises remained state-owned, even after the voucher privatization was completed in the summer of 1994, and it had proven difficult to sell enterprises for cash. Stock prices were tiny in relation to asset values, and large sales of additional stocks would have further depressed stock prices. The idea arose to offer large blocks of state shares as collateral against bank loans in open auctions; this would not depress stock prices, while the offering prices would be current market prices. Unfortunately, the auctions became closed, and the offering prices almost equaled the closing prices. As a result, Oneximbank seized control of the huge metallurgical company Norilsk Nickel and the oil company Sidanko, while Menatep took over the oil company Yukos, and Boris Berezovsky of the car dealership Logovaz got the oil company Sibneft at low prices. The sales of stocks of 15 large enterprises through this scheme attracted great public criticism, even though not all the loans-for-shares privatizations were profitable for the winners of the auctions. Contrary to prevailing perceptions, these privatizations hardly changed the system, but they transferred the benefits of management theft from some red directors to some new capitalists, and tarnished Chubais's reputation. When Oneximbank took over Sidanko, it announced that the prior management had tapped $350 million a year from the company, and these cash flows were presumably appropriated by the new main owners. Still, the total cash flows that could be expropriated from these companies could hardly have been more than half a percent of GDP a year. No qualitative change occurred. The new majority owners did not behave like owners but just continued the ordinary management theft. After a short-lived boom, the values of these companies have fallen below the low purchasing prices. For instance, Norilsk Nickel, the large non-ferrous metal company is now worth one third as much as Oneximbank paid for it in a non-competitive deal in late 1995. After the financial crash of August 1998, most of these tycoons have been cut down to size. Tellingly, the Russian newspaper *Kommersant-Daily* has described the nature of the business of the possibly wealthiest tycoon, Boris Berezovsky:

> To destroy Boris Berezovsky's "empire" is easy, primarily because it is based on the fallacious principle "do not own but manage". Berezovsky did not buy control packages of stocks… With support of the Kremlin, he simply put his people on key posts in a company, and they helped him to manage the firm as was necessary for Berezovsky (Zavarsky 1999).

The most telling fact about the privatization, however, is that the most severe criticism has all along come from the very elite widely perceived to have benefited. The reason is plain. Before privatization, state enterprises managers were quasi-owners of these enterprises, and privatization reduced their property rights, which they have tried to recover by all means. Russia has serious problems with corporate governance, which can broadly be described as management theft. Notably, managers buy inputs from their own private enterprises at high prices and sell back at low prices, defrauding the company they manage and own only partially. This can be seen as a consequence of the privatization having gone further than other reforms. Enterprise managers recover the ownership they have lost in privatization through illicit actions in collusion with the all-pervasive and corrupt state apparatus. Moreover, for the big rent-seekers the emergence of real private property rights is a threat to their state-oriented way of making money.

Although there was only one significant reformer left in the government, Anatoly Chubais, the reformers were publicly blamed for the continuing economic decline, while all the unabashed lobbyists in the government escaped unscathed. The parliamentary elections in December 1995 dealt another blow to the reformers, and the communists reemerged a serious political threat, though mainly because the reformers were split in too many parties. In January 1996, President Yeltsin sacked his last reformist minister with the oft-quoted words: “Chubais is guilty of everything.”

The Stagnation of Reform, 1996-98

As Russia entered 1996, the parliamentary elections in December 1995 cast a dark shadow. As the presidential elections in June 1996 were approaching, a new great fear of communist revenge dominated Russian politics. To counter the communist threat, most anti-communist forces joined hands, which gave the so-called oligarchs a new position of privilege. The elections highlighted the political importance of money and owner-control over media. Capitalists and media magnates Vladimir Gusinsky and Boris Berezovsky (who control the TV channels NTV and ORT, respectively) emerged as dominant political forces. The election results evidenced the political clout of Russia's new tycoons. Vladimir Potanin, Chairman of Oneximbank, became First Deputy Prime Minister, if only for half a year, and Berezovsky became Deputy Secretary of the Security Council for one year.

1996 was a year of no reform. The communists opposed market reforms, and the government contained no senior reformer. The government let the budget deficit rise from 5.7 percent of GDP in 1995 to 8.4 percent of GDP in 1996, distributing pre-election gifts. The real yields of the treasury bills peaked at 150 percent a year before the presidential elections, as the government tried to sell more than the market was prepared to buy in the face of great political risks. Moreover, access to the market was informally limited to privileged Russian banks, excluding both foreigners and households, while making the treasury bill market a source of rent-seeking. Interest payments of the federal budget increased from 3.3 percent of GDP to 5.7 percent of GDP as almost 4 percent of GDP went to the payment of yields on treasury bills (Illarionov 1998b). The IMF insisted on the opening of this market to foreign investors, which did lead to lower treasury bill yields, but it also exposed Russia to a dangerous dependence on short-term foreign capital, attracted by the still very high real yields. Hardly anything was done to attract household savings.

In the spring of 1996, the IMF concluded a three-year loan program, an Extended Fund Facility (EFF), with Russia, although nobody in the government was concerned about reform. The program requested a budget deficit of 4.0 percent of GDP, which was never a serious proposition and lacked all credibility. This was all too obviously a political decision to secure President

Yeltsin's re-election, supported by the G-7. Saved he was, but at the expense of economic policy. The EFF agreement set the stage for Russia's ensuing boom and bust. The soft IMF agreement convinced foreigners and Russians alike that Russia was too big – or too nuclear – to fail, and that anything goes in Russia. The IMF did delay a tranche in September 1996, but then the IMF had little leverage.

The IMF agreement unleashed an extraordinary inflow of foreign portfolio investment. It rose from $8.9 billion in 1996 to $45.6 billion in 1997 or 10 percent of GDP. Meanwhile, foreign direct investment increased from only $2.5 billion in 1996 to $6.2 billion in 1997 (RECEP February 1999). Roughly half the foreign portfolio investments went into federal government bonds and half to other bonds and stocks. At the peak of the stock market in 1997, foreigners might have owned as much as 30 percent of the total market capitalization of some $100 billion. The total stock of treasury bills in the summer of 1998 amounted to some $70 billion, of which foreigners held at least $25 billion. In addition, enterprise, regional and municipal bonds of substantial amounts had been issued. Thus, in July 1998 accumulated foreign portfolio holdings were at least $65 billion or nearly 15 percent of GDP. In addition, international financial institutions had provided the Russian government with over $20 billion or 4.5 percent of GDP in loans. Ironically, Russia was flooded with foreign financing – primarily private but also intergovernmental – after serious attempts at economic reform had faded.

The net result of all these inflows was capital outflows of about $20 billion in each of the years 1996 to 1998, while capital outflows had shrunk in 1994 and 1995. Rising capital outflows are a strong indication of rising rents. Hence, the foreign portfolio investments contributed both to rent-seeking and to the magnitude of the Russian financial crash. The loans to the Russian government diminished the need for the Russian state to collect taxes or cut subsidies. The conditionality of the loans from the IMF and the World Bank appears to have been ineffective, possibly because the large private portfolio investments were unconditional. Many Russian businessmen made big money by grabbing the assets of minority shareholders through transfer-pricing, seizure of assets or by not servicing bond debts. Therefore, these inflows were counterproductive both to corporate governance and reform.

Although renewed reform attempts were apparent in the spring of 1997 and the summer of 1998, the reformers in the government lacked the necessary powers to influence the real economy. Non-payments, offsets and barter proliferated rather than subsiding, suggesting that the enterprises' real budget constraints were not getting harder but softer. Clifford Gaddy and Barry Ickes (1998) have pointed out that the non-cash economy is not going away, but growing, as it is a well-entrenched system with strong incentives for many to maintain it. By 1998, about half of all inter-enterprise payments were made in barter, about one quarter in money surrogates have emerged, and only one quarter in money. The standard communist explanation of the prevalence of barter is a shortage of money in the economy, requiring additional emissions, but this confuses supply with demand. There is little demand for money, as many enterprises prefer barter and money surrogates to payments in cash, while others are too weak to insist on payment in money.

The main explanation is that barter and other forms of non-cash payments facilitate tax avoidance and evasion. As the cost of barter is usually 20-30 percent of the deal, the benefits must be substantial (Djankov 1999). In particular, value-added tax (VAT) is based on payments, and not on invoices or deliveries on an accrual basis as is the case in the West. Hence, companies that barely are paid in money are, in practice, exempt from most of their potential VAT burden. For the Russian government and the IMF, one of the most important tax changes is that VAT will be paid on accrual basis to tax barter. Enterprises also use tax debts as a means to extract government orders instead of paying taxes, which is called offsets. Offsets are by their nature discretionary negotiations between big businessmen and government officials about large amounts of money, naturally imbued with corruption. Regional governments appear most corrupt, accepting 60 percent of taxes in money surrogates, to compare with 43 percent for local governments, and about 25 percent for the federal government (OECD 1997; Illarionov 1998a).

Big industrial enterprises use barter to subdue small enterprises, too. Forty percent of the barter trade was perceived as involuntary, meaning that an enterprise was compelled to accept a payment in products it did not want (Aukutsionek 1998). Barter is also an important mechanism of management theft. The essence of the post-Soviet non-cash economy is large enterprises' reluctance to adjust to market conditions at the expense of consumers, the government and politically weaker enterprises. A monetized economy is transparent and competitive with no necessary advantages for large enterprises. A non-cash economy, on the contrary, is a relations economy, making relations with high government officials crucial for an enterprise's success, and big enterprises have more access to senior state officials.

The new tycoons were no more prepared to accept free markets than the old red directors, and they demanded their due from the government for their support in the presidential elections. In July 1997, Berezovsky and Gusinsky turned against the reformers in the government with a vengeance, because the reformers had instigated an open auction of the telecommunications holding company Svyazinvest. In October 1997, Berezovsky worked with the communists in the State Duma and Prime Minister Chernomyrdin to increase the budget deficit in an apparent attempt to undermine the reformers in government, just before the Asian financial crisis started to hurt Russia in late October 1997. The government failed to tighten its fiscal policy until February. Then interest rates had risen over 100 percent a year again. In late March 1998, President Yeltsin sacked his passive Prime Minister Chernomyrdin, but it was too late. The reformist government under Sergei Kirienko neither acted fast enough, nor possessed the necessary political support to carry out any reforms. As the crisis augured in 1998, Russia's financial problems were evident. For years, the country had maintained too large a budget deficit. As a result, Russia had accumulated a fast-growing and unsustainable short-term government debt. Therefore, creditors withdrew. Moreover, red tape and arbitrary taxation deterred both domestic and foreign investment. The Russian government made an agreement with the IMF on the necessary budget cuts in July 1998, but four major interest groups pushed their country into the abyss.

The keenest activists were some oil barons and Berezovsky who had campaigned for devaluation, although they knew that this would lead to the bankruptcy of most banks, as they held large ruble assets but hard currency liabilities. The oil producers simply wanted lower production costs in rubles and thought little about other consequences. They also suggested lower taxes for the oil industry, price controls, directed Central Bank credits to the oil industry, and inflationary emission of money (Alekperov 1998).

Second, the Russian State Duma refused to accept a government proposal to move from a VAT based on payments to accrual basis in July 1998. In effect, this would have meant the taxation of barter, which was exempt from VAT. Nor did the Duma agree to transfer any regional revenues to the federal treasury. These two votes by the Duma triggered the financial collapse.

Third, the regional governors strongly resisted any transfer of their funding to the federal government. However, regional revenues are almost one and a half times as large as the federal revenues, and the regional governors spend over 2 percent of GDP on enterprise subsidies, which are disbursed in a discretionary fashion to their liking. Therefore, anybody elected governor can freely dispose of a large amount of money, which entices criminals to be candidates for regional governorships.

A fourth group contributed indirectly to the financial collapse. It is the state bureaucracy, which has doubled in the midst of economic crisis and expanded by no less than 1.2 million bureaucrats from 1992 or almost two percent of the labor force. Many are inspectors of various kinds. Enterprises became subject to extraordinary bureaucratic interference in enterprises, which deters investments and entrepreneurship.

The behavior of these groups was socially irresponsible, but they acted in line with their recent experiences. They had learned that the most ruthless rent-seeker is the most successful. Another lesson learned was that the economic environment changes all the time, rendering intelligent improvisation the road to prosperity. Many games were played only once. Therefore, they seized any possibility instantly. Their useful reputation was to be cunning and dangerous rather than honest. The crash can also be seen as a result of intense competition for shrinking rents, as the rent-seekers were trying to preserve their incomes.

Russia's Strategic Problems

A few economic problems seem key: inability to collect planned government revenues, failure to rationalize expenditures, and mitigated competition. First, the Russian government has continuously attempted to collect more taxes than it can. The Russian tax system is an unfortunate combination of the old Soviet tax system, a hasty partial tax reform in 1992, inconsistency, and dubious legal changes often motivated by rent-seeking. It collects little revenue, but it is unjust, and the tax burden is unevenly distributed. While businessmen with good political connections are more or less exempt from taxation, actual taxation is confiscatory for others, forcing many small entrepreneurs out of business or underground. However, it is not true that Russian state revenues are particularly small or falling sharply. Total state revenues match US revenues, and in the CIS only Belarus and Ukraine have significantly higher revenues. Total state revenues actually rose from 31.0 percent of GDP in 1995 to 32.0 percent of GDP in 1998. Even federal revenues were almost constant around 12 percent of GDP from 1994 to 1998 (see table 1). As Vito Tanzi (1999) has pointed out about transition economies, "one would expect that over time there would be a tendency for the share of taxes into GDP to fall towards the 15-25 percent range prevailing in richer developing countries even though in some of the transition economies the tax to GDP ratios might still be much higher at the moment."

Second, the government has failed to rationalize its expenditures, often not paying its commitments, although public expenditures are amazingly futile. As Russian public and social expenditures are highly regressive, the poor are unlikely to suffer from budget cuts. Last year, the Russian Ministry of Labor and Social Affairs calculated that 70 percent of all social transfers went to the 30 percent most wealthy households, but all their attempts at reform were defeated.[5] Similarly, a World Bank study in 1994 showed that the poorest 20 percent of the Russian population receive only 6 percent of all social assistance (Milanovic 1998). Russian public expenditures have lingered around 40 percent of GDP, but almost half cannot be justified from any social point of view. It is easy to suggest socially beneficial budget cuts in Russia. Four percent of GDP is being spent on enterprise subsidies, which breed corruption and organized crime, while impeding enterprise restructuring. Half comes from the federal budget and half from regional budgets. Another four percent of GDP from the regional budgets is devoted to housing and utility subsidies, focusing on people with large dwellings in big cities. The government bureaucracy has doubled since 1992 and consumes about four percent of GDP. At least half of this bureaucracy needs to be eliminated to allow for entrepreneurship. Finally, about one percent of GDP from the social Insurance Fund goes to pure Nomenklatura privileges, such as government hotels and boarding-houses for the privileged (Dmitriev 1997). Thus, without even touching social concerns the Russian government could cut eleven percent of GDP in socially harmful expenditures. Most post-Soviet countries have already done most of this, showing that it is possible, but they have done so only when they have been forced to because of lacking revenues and financing. Such cuts would enhance transparency and make it easier to establish a targeted social safety net for the truly needy.

Third, markets of all kinds function badly, leading to high transaction costs and limited competition, reflecting a lack of deregulation and the absence of the effective rule of law. The liberalization of the Russian economy has been a drawn-out battle, and state intervention remains as intense as arbitrary. Virtually all economic activities are subject to licensing, and multiple licenses are usually required. Over 60 state agencies undertake enterprise inspections, and hundreds of thousands of state inspectors attempt to extort bribes. Therefore, Russia ranks very low on all liberalization indices (EBRD 1998; World Bank 1996a; De Melo, Denizer, and Gelb 1996). For instance, the extensive Index of Economic Freedom of the Heritage Foundation and the Wall Street Journal puts Russia as number 115 out of 148 countries (Holmes, Johnson, and Kirkpatrick 1997). A natural consequence is that corruption is pervasive. In its Corruption Perceptions Index for 1998, Transparency International puts Russia among the most corrupt, as 76 among 85 countries (Transparency International 1998). Hence, prices and markups are still high; the choice of goods and their quality are not very impressive; regional price differentials remain sizable; and Russia has few enterprises. The total number of legally-registered enterprises

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[5] Personal communication from then First Deputy Minister of Labor and Social Affairs Mikhail E. Dmitriev.

reached 2.7 million in 1997, which is only one enterprise per 55 Russians, while a ratio of one enterprise per ten people is normal in the West and in the successful reform countries Poland and Hungary (Åslund 1997). Yet, shortages of goods and services pertain to the past and competition seems to increase steadily (Brown and Brown 1999).

Economically, the solution is obvious, and Russian governments as well as the international financial institutions have made reasonable proposals for years. A fundamental tax reform is needed to simplify the tax system, reduce the number of taxes, broaden the tax base by abolishing exemptions, and reduce top tax rates. A far-reaching deregulation is needed, and abusive government interference has to be curbed. Real private property rights, including private ownership of land, are necessary. Natural monopolies require market-conform regulation. A reinforcement of the rule of law as well as a social reform to establish a targeted social safety net are needed. Hundreds of sensible laws have been drafted, but many lie waiting for consideration in the Duma.

The question is why hardly any such reforms have been adopted. A whole Western school of political economy literature has argued that radical reforms were not democratically possible, as they would lead to too sharp declines in output, so that they would provoke popular protests (e.g., Przeworski 1991), but this literature suffers from two severe deficiencies. First, their standard assumption was that radical reform would lead to a greater decline in output than gradual reform, which has been disproved empirically. Moreover, the losers have suffered far worse in countries with no radical reform, because of not only falling output but also increasing income differentials (World Bank 1996a; Milanovic 1998). Third, these scholars assumed that workers or the public would rise, but the population or the losers have not posed serious political problems. Russia has had a minimum of popular unrest and few strikes in spite of huge wage arrears. Instead, the threat to reforms was a limited number of winners from the transition, who enriched themselves from extraordinary rent-seeking, caused by initial partial reforms (Hellman 1998). This is what a student of Mancur Olson's (1971) *Logic of Collective Action* would have anticipated, because civil society and the state as a representative of public interest were weak, while the big rent-seekers were few, strong and well-organized. They do not care about common welfare but do their utmost to maintain a maximum of rents, forging links with politicians and officials, who can promote their business interests, and invest their newly-won fortunes in politics to facilitate future rent-seeking. They want a large and non-transparent state administration thriving on corruption, as liberal regulatory reforms would expose them to competition. The rent-seekers favor a cumbersome tax system for others and tax exemptions for themselves. Secure private property rights strengthen their competitors and should therefore be avoided.

If rent-seeking is the key determinant for Russia's future, we need to assess it.[6] Rent-seeking peaked in 1992, when the main rents were: subsidized credits to enterprises (23 percent of GDP) + export rents (30 percent of GDP) + import subsidies (17.5 percent of GDP) + direct budget subsidies (10.8 percent of GDP) = 81 percent of GDP.

Until 1995, rents plummeted. By 1994, the subsidized credits and import subsidies were gone. Export rents contracted, and they can be estimated at 3.7 percent of GDP in 1995.[7]

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[6] We take a narrow view of rents, as caused through government action, primarily direct or indirect government subsidies. We consider rents as annual flows, not as stocks. We are only concerned with rents going to enterprises, ignoring social expenditures. Considering the arbitrary tax system and collection practices, a correct tax standard can hardly be established, which makes it impossible to assess the value of tax exemptions appropriately, compelling us to disregard tax exemptions. Presumably they have developed in parallel to tax revenues, which have fallen slightly. For the same reason we leave the benefits from barter and offsets side, which have clearly increased over time. Monopoly rents tend to be estimated at 0.5-1 percent of GDP in a Western economy, and they are likely to be several times larger in Russia, but they are difficult to estimate, which forces us to ignore them. They have probably fallen over time, as regional price differentials have contracted. We also leave aside racketeering fees, which appear to have declined. We are looking at rent-seeking from the gross cost side, while net revenues are much smaller.

[7] Oil and natural gas prices were on average about one third of the world market price in 1995, but a free market

Enterprise subsidies fell sharply in 1995 to 3.4 percent of GDP. We may include half a percent of GDP in rents from the loans-for-shares privatizations. Yet, the narrow rents we focus on amounted to only about 8 percent of GDP in 1995.

Export rents continued falling, but they might still have been 2 percent of GDP in 1997. Enterprise subsidies recovered slightly to 4.2 percent of GDP in 1997. A new category of rents was excessive returns on treasury bills (about 3 percent of GDP). By rents we mean free money for the elite. Then, we should also include foreign portfolio investments going to the Russian private sector, appropriated by ruthless businessmen because of a poor legal order or government inaction. We include enterprise bonds (about 2 percent of GDP in 1997), stock investments (some 4 percent of GDP).[8] Thus, these rents amounted to 15 percent of GDP in rents in 1997 or almost a doubling of the rents from 1995.

The financial crisis of August 1998 eliminated the rents related to foreign financing, as well as the excessive returns on treasury bills. The only remaining rents are enterprise subsidies, and some refinancing of banks, so far less than half a percent of GDP, or a total of around 5 percent of GDP. Hence, the financial crisis seems to have cleaned out many rents and possibly prepared the ground for a low-rent economy, though rents might reemerge. Figure 1 presents an approximation of the development of these rents in Russia in the 1990s.

[Figure 1 approximately here]

This leads to several important propositions. First, the degree of rents in Russia and other CIS countries was so high in 1992 and 1993 that the rent-seekers were all too likely to win.

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price would probably have been about two thirds of the world market price, because of the high transportation costs. Therefore, the export rent can be assessed at about one third of exports of oil and natural gas. In 1995, total Russian exports of oil, petroleum products and natural gas amounted to $39.3 billion, and GDP was $357 billion (Goskomstat 1997, pp. 577, 582, 586; Brunswick 1999).

[8] Rents can be defined in various way in 1997. The essence is that foreign portfolio investments of 10 percent of

Countries that succeeded in early, radical reform, such as Estonia and Poland, had much lower levels of rents (Åslund, Boone, and Johnson 1996). This helps explaining why radical reforms were successfully implemented in some countries but were ferociously resisted in the former Soviet Union. Second, the most damaging policy was the policy that boosted rents the most, which was the loose monetary policy, reinforced by the maintenance of the ruble zone. It boosted rents directly, but also indirectly. As a result of high inflation, the market exchange rate plummeted, which aggravated the extreme differences between controlled domestic and free foreign prices. Third, a necessary but not sufficient condition for successful reforms is that the rents fall below a certain level, which can possibly be assessed in comparative empirical analysis. Fourth, if the resistance of rent-seekers explains the problems to undertake sensible reform, disorganization does not seem a plausible explanation of the output decline contrary to Blanchard and Kremer (1997). Sheer disorganization would not have lasted for so long, if it was not in someone’s interest to maintain it.

Rent-seeking also helps us understand the financial crash of August 1998. It can be seen as the outcome of intense competition over evasive rents. While socially costly, the crash has at least temporarily minimized rents, thus providing one of the necessary preconditions for reform, though most other conditions seem absent. To keep rents low, the average tax burden should be diminished, because that reduces the value of tax exemptions, and it would be utopian to believe that they can be abolished in the current Russian political climate otherwise. The dangers of large foreign portfolio investments have probably been sufficiently well illustrated to foreign investors, so that an early repetition is unlikely. The best hope for the future seems a fierce competition over rents, which eventually will minimize them. Conversely, Andrei Shleifer and Robert Vishny (1993)

GDP in 1997 was loose money up for grabs, distracting people from ordinary profit-seeking.

have suggested that corruption is best minimized through the encouragement of competition over bribes. Even if rents are not homogenous goods, the same principle should apply. Similarly, Robert Ekelund and Robert Tollison (1981) have argued that mercantilism in England was broken up by a struggle between the royal court and the parliament over rents.

Alternative Policies

Today Russia's economic policies in the last eight years look like a serious failure. Yet, it is still too early to judge whether this decade has been productive. During the last five years, Poland has enjoyed an average growth rate of 6 percent a year. Its economic success had hardly been possible without a seemingly lost decade in the 1980s, which altered the thinking of the people and the government, which reluctantly undertook significant reforms because of economic crisis and the absence of the international financing. As a result, young Poles increasingly turned from rent-seeking to profit-seeking, and from government service to private enterprise. Poland's real break-through, however, came after a second financial crisis, democratization, electoral victory of reformers, and a comprehensive radical reform program, supported by substantial international financing. Few remember the discussion in the early 1980s about how Poland could not possibly succeed in reforms because of Poles' distrust of the state after over two hundred years of foreign occupation and the harmful escapism of Polish Catholicism.

Many suggestions have been made about what alternative policies would have been better for Russia. Initially, we need to debunk a few myths about the actual state of affairs in Russia. Next, we shall discuss some beneficial options that appeared to be open as the reforms started. Then, we turn to some often made proposals that had either not been feasible or harmful. Finally, we shall review a few major outstanding policy issues.

To begin with two big myths should be debunked. First, Russia is by no means a neo-liberal state but a crony state, where the state remains the source of the main fortunes. There is a consensus among those who promoted radical reforms, that on the whole the reforms which were actually implemented were not radical (Dabrowski 1993; Sachs 1995; Aven 1999; Fedorov 1999). This assessment was also reflected in the World Development Report on post-communist transition (World Bank 1996a). An extensive academic literature and a broad public debate have favored larger budget deficits, more monetary emission, and slower deregulation of prices and foreign trade.

The arguments for softer macroeconomic policies have been many. The risk of high inflation has frequently been understated. Richard Portes (1993, p. 40) surmised: "The results of economic transformation so far have been remarkably similar. The stabilizations have been relatively successful. The initial jump in the price level is always greater than expected, sometimes so much that significant inflation persists; but the rate does come down rather than taking off into hyperinflation." That year, ten post-Soviet countries experienced hyperinflation. The standard argument against tight macroeconomic policies has been their purported negative effect on demand and output, as Mario Nuti and Richard Portes (1993, pp. 10-11) put it: "There has undoubtedly been a strong negative demand shock resulting from macro policies. …. But we must definitively reject the rationalization that macroeconomic stabilization must have a substantial through temporary cost in terms of lost output." In a similar vein, the Vienna Institute for International Economic Comparisons argued for looser monetary policies on the ground that "a better appreciation of the role of aggregate demand in determining the level of economic activity through the 'multiplier analysis' would have predicted more accurately the depth of the recession…" (WIIW 1993, p. 19). Their argument was that less demand leads to even less output in a vicious circle. Lance Taylor (1994) proceeded that “reducing inflation may be impossible unless and until output starts to increase,” and that “there is not likely to be output recovery in the absence of activist investment policy on the part of the state.”

The Russian debate was simpler and more straightforward. A mainstream among the enemies of reform argued that inflation was caused by price liberalization, while the fall in output was a result of a lack of demand, because of too strict a monetary policy. The problems were structural and could only be solved with selective government intervention. The strict monetary policy was shown by how M2 had fallen in relation to GDP. The solution was sought in selective price and wage control, protectionism and an industrial policy that included subsidized credits to select companies. In general, more government intervention was requested, while budgetary policy was usually ignored. The critics argued that shock therapy had been carried out and everything was blamed on it (Bogomolov 1996).[9] All those who favored more gradual reforms in Russia can now praise themselves for having won. They should also take the blame for the actual outcome rather than boasting that they predicted that radical reforms would not succeed in Russia.

The other big myth of the Russian transition is that privatization has been the main source of enrichment. However, today we know that this is not true. The fortunes have been made on export rents, subsidized credits, import subsidies and other rents, which enterprise managers have expropriated through theft. The idea that privatization has been the main source of the Russian fortunes should be discarded as sheer prejudice. Moreover, Russian enterprise ownership is reasonably well distributed, and the problem is rather that ownership has not become effective.

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[9] Curiously, this list of complaints was signed by four American Nobel-prize winners in economics, Kenneth Arrow, Lawrence Klein, Vasily Leontieff, and Douglass North.

Privatization is no alternative to deregulation, though it might facilitate deregulation in the future. Nor has privatization been an effective impediment to rent-seeking. In the financial crisis of 1998, the Russian tycoons did not behave like capitalists, who care about the value of their property, but like rent-seekers, only thinking of the short-term cash flow.

To comprehend Russia's initial transition, it is useful to focus on the problem that Russia's market reforms were not perceived as credible. The top businessmen knew that rent-seeking was the name of the game. Rather than trying to adjust to market economic rules, they successfully pressured the government to maximize their rents. In these concrete circumstances, what could have done to enhance the credibility of the change of economic rules? The shock was already great and multifaceted. The government did liberalize most prices, abolish price subsidies, liberalize imports, and cut military procurement sharply. Characteristically, there was no going back on these reforms that were truly radical and changed the rules for good. However, the reform government failed to maintain a balanced budget for more than the first quarter of 1992, control monetary emission, unify the exchange rate, liberalize commodity prices, and deregulate exports. The disruption from the old system could have been greater and more could have been done to build early new institutions designed for democracy and market economy.

The reform government implied a stark institutional disruption, and the central Soviet government apparatus was sharply reduced. Almost all old branch ministries were abolished, but the State Planning Committee, the State Price Committee, the agrarian organizations, and the KGB survived for no good reason, and they caused a great deal of damage. An even greater organizational discontinuity was feasible but it was not undertaken. As the reform did not go far enough, dozens of branch ministries soon reemerged.

The old Soviet government cadres were incredibly hostile to all reforms. A lustration had been desirable to sort out a staff that really sabotaged government policy, but that was never a political possibility. However, Yeltsin could have brought in thousands of well-educated activists from the movement Democratic Russia, but he excluded it and instead turned to old communist party cadres that had been laid off. Although new cadres have gradually been trained, this was an enormous lost opportunity. The point is that Russia had a significant social capital that was not utilized. The old state apparatus and its cadres, on the contrary, represented an impediment of negative institutions and learning. Russia's important social capital was hardly concentrated in the old state administration because of decades of negative selection (Amalrik 1980).

President Yeltsin was always under great political pressure limiting his options, but he had no political or constitutional strategy. Russia's basic state institutions were very weak. Moreover, for the first one and a half years, the reforms were supported by a popular majority as opinion polls showed as well as the referendum in April 1993, when 52 percent even approved of the radical economic reform policies. The best way of doing so would have been to dissolve the semi-democratic parliament and hold early parliamentary elections, and the early formation of a reform party. In parallel, a new constitution could have been adopted early, instead of amending the old dysfunctional Soviet Russian constitution, which could be altered any day by a qualified majority of the Russian parliament and eventually led to a violent parliamentary uprising. However, President Yeltsin failed to mobilize this reformist majority, and after his shoot out of the old parliament in October 1993 it no longer existed.

As discussed above, the ruble zone could and should have been abolished early on, as it hindered financial stabilization and facilitated huge rent-seeking.

The West had a big chance to make a difference at the beginning of 1992. The West and the US enjoyed enormous good-will in Russia and had great influence. All the necessary measures

– liberalization of commodity prices, deregulation of exports, unification of the exchange rate, and positive real interest rates – were standard elements of an IMF program and they were desired by the Russian government. As never before or later, President Boris Yeltsin appealed to the West for help but in vain. The West was preoccupied with securing the Soviet debt, and instead of providing money for reforms, it gave commodity credits to rent-seeking commodity traders.

Later on, reforms have been much more difficult to undertake. The rent-seekers were possibly making less money then, but they were well entrenched, with connections in the government and parliament. The only major success was the stabilization program in 1995. Chubais made a coup by cutting the deficit, focusing on truly indefensible expenditures at the same time as he cut total revenues. The stand-by agreement of the spring of 1995 was the IMF's finest achievement in Russia, as discussed above. The IMF and the World Bank were instrumental in the deregulation of foreign trade, which eliminated most foreign trade rents.

In contrast, the EFF in the spring of 1996 appears a great mistake by the IMF. The budget deficit was widening, and the Russian government had no credible commitment to reform. Through the EFF, the IMF signaled that Russia was too large to fail regardless of economic policy, which encouraged an excessive inflow of foreign portfolio investments. Furthermore, the IMF reacted to the high yields on treasury bills, by persuading the Russian government to open its treasury bill market to foreign investors rather than pushing for a smaller budget deficit. The resulting large inflows of foreign portfolio investments increased Russia's vulnerability to contagion from the Asian financial crisis and contributed to its financial crash.

Let us scrutinize some common proposals about what should have been done instead. First, the argument is often made that the reformers should have tried to compromise with the opposition. If anything, the reformers compromised far too much. The only reasonably successful compromise was the privatization scheme, which explicitly considered the interests of the managers (Boycko, Shleifer, and Vishny 1995). All other attempts at compromises have been unsuccessful. When the reform government could no longer block directed government enterprise credits, it tried to steer them to “progressive” state enterprise managers, whose only advantage was diplomatic skills. In the most successful reforms – Poland and Estonia – reformers took enormous heat, The acrimony in the Polish economic debate was extraordinary from 1989 when the reforms were launched to 1992, when the reformers had broken the rent-seeking paradigm (see e.g. Bozyk 1992). Only later on, the political consensus for reform emerged (Balcerowicz 1994). The fundamental weakness of Russia’s reformers was that they never were supported by a parliamentary majority, which seems a near condition of successful reforms. Furthermore, the Russian reformers compromised themselves by staying in government dominated by people serving the interests of rent-seeking lobbies. While Chubais succeeded in his stabilization policies in 1995, in the long term reformers might have lost more in the public eye for corrupt deeds by non-reformers in the same government.

Second, in Russia, the argument is often made that Russia needs a dictator like General Pinochet to undertake successful reforms. However, this point is mostly raised by people who do not want real market economic reforms, and the problem was not the exceedingly patient Russian people but the old Soviet establishment, which had to be controlled somehow. As the Soviet dictatorship had not succeeded to control the elite, democracy, transparency and accountability seemed more effective options than dictatorship (Maravall 1994). All reasonably successful reform countries in the former Soviet block are democracies (Åslund, Boone, and Johnson 1996)

Third, many have called for industrial policy. The Russian industrial lobbyists have advocated industrial policy all the time, with references to its success in South Korea and Japan.

However, by their standards Russia has had a great deal of industrial policy and we can see that it has been not only ineffective but harmful. In Russia, industrial policy has been a code word for subsidies. Three industries have secured most subsidies for themselves: coal industry, agriculture and the military-industrial complex. As a result, trade in their products has become criminalized, as subsidies imply not only rent-seeking, but also a strong inducement to organized crime, as is evident in the coal industry (LaFraniere 1999). It is doubtful whether any government can manage industrial policy without falling into the trap of corruption, but there can be no doubt that Russian industrial policy is bound to be totally corrupt. While Minister of Finance in 1993, Boris Fedorov used to respond to complaints about his lack of industrial policy, saying that the government had dozens of ministers responsible for industrial policy. Why should he who was the only minister who cared about the finances of the state do industrial policy as well?

Fourth, a common view is that it was wrong to launch reforms before the necessary legislation had been adopted. In reality, this is an argument against ever contemplating significant reform. In Russia it was primarily made by the foes of reform. A parliament that opposes reform is not going to adopt market economic legislation, as we have seen in Russia for the last seven years. Reformers need to thrive on momentum. Typically, they all of the sudden get a chance to form a reform government, often for exogenous reasons. The political situation hardly ever allow them to sit down and promulgate a couple of hundreds of laws before they launch the reform. Only the reformers in the Czech Republic had such a strong political mandate that they could do so. Most reformers need to use a brief window of opportunity to change the fundamental rules of the game, and most reform laws have been adopted soon afterwards. Many reform laws will never be adopted, if no concrete interest has been formed that demands such laws.

Fifth, a similar fallacy is that the state should simply reform or that technical assistance should teach bureaucrats do their jobs. However, if the main preoccupation of the bureaucrats is rent-seeking, they are usually too corrupt to be useful. Advice to a bureaucrat to reduce his power and revenues cannot possibly work. Nor is it realistic to suggest that a parliament that opposes private ownership should legislate the sanctity of private property. The impetus for reform usually comes from the outside, and if the political will is absent little can be done, and the state must be unloaded from the worst rent-seeking before it can be reformed.

Finally, there are a few outstanding policy questions, concerning how more radical and comprehensive reforms could have been implemented. A difficult issue is how the reform agenda could have been made more comprehensive to enhance the possibility of success. While more interests could have been satisfied, the administrative capacity of the reformers was desperately short, and the focus should be on policies that could not easily be manipulated by corrupt interests. Far too often, however, suggestions are made that reforms should be made that run against key interests of major rent-seekers, who are fully mobilized, without these proposals being accompanied with any political recipe for success. For instance, bank regulation and financial sector reform can hardly be imposed when rogue banks flourish. Social reforms require the involvement of large numbers of officials, who tend to be hostile to reform. Many of them need to be exchanged or eliminated first.

One policy that was never very successful is the exchange rate policy. Initially, Russia had so small reserves that it had no choice but to float. If international support had made reserves sufficient, if the ruble zone had been broken up, and if the Central Bank had pursued a responsible policy, an early peg would have been a good means to bring down inflation (Sachs 1995). The float was not much support, and the exchange rate seems to have been manipulated for rent-seeking purposes, notably in October 1994, though it did facilitate the unification of the exchange rate. The financial stabilization of 1995 was accompanied by the establishment of a currency band ("corridor"). While it facilitated stabilization, it inspired a false sense of security, encouraging an excessive inflow of foreign portfolio investment. Later on, when commodity prices fell, it led to the overvaluation of the ruble and eventually to the financial crash. The failure of two policies raises the query of whether a totally different policy would be better, opening the temptation of a currency board, that was embraced by one prominent economic politician, Boris Fedorov, in the fall of 1998. After such a bout of rent-seeking, any policy that can mitigate rent-seeking looks attractive, and a currency board makes the manipulation of the exchange rate very difficult.

However, an orderly decentralization can enhance the capacity of the state and surpass some corrupt bulwarks. The Russian thinking about the nature of the Russian Federation is still confused, and early on Westerners seemed much more interested in fiscal federalism than any leading Russians (Wallich 1994). Initially, the new Russian government understandably only thought of the survival of the Russian Federation and tried to centralize control over monetary and fiscal policy in the hands of the Ministry of Finance and the Central Bank. However, the central government was overburdened and could not pursue any meaningful control over the regions. There was no clear division of revenues or tasks between the three administrative levels. The regional transfers from the federal government grew rapidly to a peak of 4.1 percent of GDP in 1994. Ironically, they tend to go to the regions that voted against the government in reform in the elections both in 1993 and 1995, and not to the regions with the greatest social need, showing that these transfers only reflect the weakness of the federal government (Treisman 1996, 1998b; Lavrov 1997). The best opportunity for a clear division of responsibilities between the federal and regional governments was probably in 1995, when the regional transfers were reduced by 60 percent.

While everybody claims to favor fiscal reform, it has proved politically very difficult, as the resistance is enormous. The experiences of other countries give us some hints (Gaidar 1998). Three CIS countries – Georgia, Kazakhstan and Kyrgyzstan – have managed to undertake sensible, radical tax reforms. All these reforms were preceded by a collapse of public revenues. The upshot is that Russia must opt for much lower public revenues, if a tax reform is to become politically possible. The logic is that the value of tax exemptions fall with lower average taxation. The successful Russian stabilization in 1995 supports this thesis. Similarly, a radical government and expenditures reform seems only to be possible in the CIS with a sharp reduction in state revenues. The countries with the largest public expenditures seem to maintain the most harmful structures of public expenditures (notably Belarus, Ukraine and Russia). None of the reform countries with still sizeable public expenditures (Ukraine, Russia and Moldova) has actualloy turned to growth, while the four CIS countries that have recorded significant growth rates after having hit bottom (Georgia, Kyrgyzstan, Armenia and Azerbaijan) had unweighted average state revenues of 16.8 percent of GDP in 1997 (Tanzi 1999). The evidence to date suggest that the CIS public sectors are such a bad cancer that they must be reduced much more than has proven necessary in Central Europe or the Baltics before they can perform any social functions again.

For the international community, these observations mean several things. First, the will to reform should be an even stronger criterion for international assistance. Then the EFF with Russia in 1996 could have been avoided or the World Bank coal loans. Second, the emphasis should be more on the reduction of harmful public expenditures and rent-seeking practices than on revenue-raising measures. Then, the IMF would be more interested in the reduction of harmful public expenditures than in the raising of revenues. Third, some post-Soviet countries have succeeded, showing that it is possible, but only after truly radical reforms. Therefore, the qualitative threshold for international assistance should be raised rather than lowered. Fourth, serious reforms should be given all the more support to show that positive changes are possible within the foreseeable future, a hope that is now fading as the light at the end of the tunnel has temporarily been turned off.

Finally, it is becoming less clear what is right and wrong in privatization (Nellis 1999). Russia has succeeded in transferring most property rights of large and medium-sized enterprises. Many observers were impressed that Russia managed to undertake any kind of orderly privatization in the absence of social consensus. Contrary to common perceptions, substantial enterprise restructuring is going on, though less than in Central Europe. The total number of enterprises is continuously increasing, since the old enterprises are multiplying through partition as they should. However, the concern is that Russia's new big businessmen have adopted the behavior of the old red directors, living on the state rather than on the market. In particular, the loans-for-shares privatization seems to have speeded up this transformation. Property rights, corporate governance and financial markets seem pretty retrograde, raising the question whether a slower privatization of a higher quality would have been a plausible option. To date, the new capitalists have not formed the desired bulwark of capitalism, and they do not really push for deregulation and the rule of law. Still, Russia's 2.7 million enterprises may still save the day, after the rent-seekers have gone bankrupt.

Conclusions: Lessons from the Russian Transition

The main problem with the Russian transition to a market economy was that there was no radical reform, therefore rent-seeking became excessive, and the rent-seekers became too rich and powerful. Consequently, they have bought Russian politics. They made their money on export rents, subsidized credits, import subsidies and direct government subsidies, but very little money on privatization. The strength of the rent-seekers arose out of the Soviet legacy, which allowed a small group to do what it wanted, while others were restrained by weak a but large and intrusive state. The state was weak because of massive rent-seeking, caused by too much state intervention and too high state revenues, not by any excessive reduction in the role of the state.

Radical economic reform had a real chance at the beginning of 1992 because of the tremendous economic and political shocks Russia faced. Soon, the reformers lost out on the liberalization of commodity prices and exports, monetary restraint, the break-up of the ruble zone, the abolition of import subsidies and the freedom of enterprise. Therefore Russian reforms were slow and partial. President Yeltsin could have done more by calling for early parliamentary elections, forming a democratic political party, adopting a new constitution early on, and undertaking greater changes in government staff. The West could have made the difference with an ordinary stabilization package, but the window of opportunity lasted only for the first quarter of 1992. An even more gradual reform in any regard would presumably have led to even worse results. Russia would not have benefited from slower price liberalization, slower liberalization of foreign trade, larger budget deficit or more monetary expansion. The problem of privatization is not that it has enriched the managers, but rather that it has done too little to constrain them and their management theft.

The end of the Soviet Union saw an explosion of rent-seeking, which explains most of the disastrous economic performance of the whole region. By 1995, rents had come down sharply for a large number of reasons, including a radical cut in subsidies and a strong stand-by agreement with the IMF. The EFF of the spring of 1996 indicated that Russia may have an excessive budget deficit and no reforms, and still get international financing. It facilitated an excessive inflow of foreign portfolio investment, which contributed to the financial crash in 1998. The IMF should have been firmer in its demands and not have pushed for the liberalization of short-term capital.

The financial crash of August 1998 minimized rents at least temporarily. The argument of this paper is that a limited level of rents is a precondition of successful reform. Therefore, government policy should focus on keeping rents low and squeezing the rent-seekers. The most rigorous approach seems to be to encourage a competition over rent-seeking so that it becomes more lucrative to turn to profit-seeking. To replace one rent with another rent is not likely to improve the system. If a tax reform is to succeed, total state revenues need to be reduced, because then the value of tax exemptions decline, and they cannot possibly be abolished in Russia's political climate, when average taxes stay high. Lower state revenues would also force the government to cut public expenditures and the state administration, which is likely to be socially beneficial.

This reasoning leads to the following recommendations for a future course for the international financial institutions in Russia:

1. The overall tax rate – the share of state revenues in GDP – should be reduced to the level of 20-25 percent of GDP to reduce the value of tax exemptions, which would both reduce rent-seeking and the incentives to indulge in barter. It would facilitate the radical tax reforms that much of the Russian and international community has recommended for so long (with a few broad-based taxes with low tax rates). This would mean a radical change in IMF policy towards Russia, which is mainly pushing for higher state revenues. Russia needs a strong well-functioning state, but the Russian state can only grow strong and carry out its key functions, if it is relieved from ballast of corruption and rent-seeking.

2. Lower revenues would force Russia to reduce public expenditures. The experience from those CIS countries that have done so is that the most harmful expenditures go, when the cuts are sufficiently severe. When public expenditures have been reduced, it should also be easier to undertake the desirable social reforms, as the corrupt motives of bureaucrats that hampered them are no longer fed.
3. Lower state revenues also facilitate substantial cuts in the public administration, as we are already seeing after the financial crash.
4. As long as Russia does not have a government that is actively pursuing reform of its own will, with the support of a reformist majority in parliament, the IFI attitude should be skeptical. Seemingly, the IMF has influenced Russian policy more effectively after August 1998, when it has provided no funds than in the period March 1996 till March 1998, when it gave substantial amounts.
5. One lesson from the Russian financial crisis is that the IMF should not accept a large budget deficit or encourage short-term foreign borrowing by governments but be more conservative in its demands on fiscal policy. Budget deficits of more than 3-4 percent of GDP should rule out any IMF program.
6. Another lesson is that a pegged exchange rate with insufficient reserves is likely to lead to disaster, and the IMF should insist on a floating exchange rate – or possibly a currency board – but nothing in between.
7. Russia suffers from an unresolved problem of federalism and fiscal federalism. A clear division of responsibilities and taxation between the federal, regional and municipal levels is needed.
8. A new approach to structural reform is needed. For long, the World Bank has tried to

minimize the number of government authorities that are allowed to issue licences, but Russia has now over sixty agencies that issue licences or inspect enterprises. To attempt to minimize the number of inspecting authorities means in effect to boost their monopoly rents. An alternative approach is to encourage competition over rents and bribes, until they decline so much that corrupt bureaucrats no longer resist radical deregulation. If their bribes shrink, the most greedy will depart for the private sector. One possible way of developing competition over bribes is to allow federal, regional and municipal authorities to issue all licences that anybody issues in parallel. Competition already exists. Russian passports can either be issues by the Ministry of Interior or by the Ministry for Foreign Affairs. The former takes months but costs a minimum, while the Ministry for Foreign Affairs can issue a passport in a about week for a fee of $250-$350. In Kyrgyzstan, three different authorities are competing in land registration, which has speeded up land reform.

9. In order to shield small entrepreneurs and make them a part of the official economy, lump sum taxes should be introduced on a large scale. It was a major cause of the success of private enterprise in Poland under communism (Åslund 1985).
10. At this stage of the transition, major success indicators should be structural and not only macroeconomic. One example of a suitable microeconomic indicator is the number of legally-registered enterprises. Another option is a relevant liberalization index, but they contain too many elements to be concrete objectives, and relevant weights of various elements are hard to assess.
11. The World Bank should see it as one of its main aims to fight rent-seeking and corruption. Then, it should abstain from pouring money into the central government

authorities of notoriously corrupt industries, such as coal or agriculture.

12. Russia suffers from a weak civil society. A natural task of non-governmental organizations is to assist in the working of a social safety net. The World Bank could reach out directly to them.

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Table 1

Key Economic Data for Russia, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
GDP, $ bn	79	159	277	357	429	450	272
GDP, annual increase %	-14.5	-8.7	-12.6	-4.2	-3.5	0.8	-4.6
CPI % year end	2,510	842	224	131	22	11	84
Unemployment %	4.9	5.5	7.5	8.2	9.3	9.0	11.8
General government							
Revenues % of GDP	39.2	36.2	34.6	31.0	31.0	32.6	32.0
Expenditures % of GDP	57.6	43.6	45.0	36.8	39.3	39.9	36.5
Budget deficit % of GDP	-18.4	-7.3	-10.4	-5.7	-8.4	-7.4	-4.5
Federal revenues % of GDP	15.6	13.7	11.8	12.2	13.0	11.6	11.3
Regional revenues % of GDP	13.5	16.7	18.0	14.2	14.5	16.1	14.8
Of which transfers	1.7	2.6	4.1	1.6	2.7	2.9	1.7
Extrabudgetary revenues	10.9	8.6	9.1	7.6	7.7	9.1	..
Enterprise subsidies % of GDP	10.8	9.4	10.5	3.4	3.9	4.2	..

Note: All these data are subject to continuous revisions and as they are gathered from various sources, there are minor inconsistencies between certain numbers, but they are all based on standard IMF definitions.

Sources: Tanzi (1999), Illarionov (1998b), World Bank (1996b), Bank of Finland (1999), and Brunswick Warburg (1999).

Figure 1