Russia’s Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed

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RUSSIA'S CAPITALIST REVOLUTION

WHY MARKET REFORM SUCCEEDED AND DEMOCRACY FAILED

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ISSUES

1. Revolution: Important for our understanding
2. Why did market reform succeed?
3. Why did democracy fail?
4. Who is Mr. Putin?
5. Russia’s Future?
1. Key to Understanding Russia’s Transformation: It was a Revolution.

Literature on Russia’s transformation fall into two categories: Those who recognize it as a revolution and the others.
Revolutionary Situation

“communist societies...are in the throes of a serious systemic crisis which...fits very well the concept of a ‘revolutionary situation’ as defined by Lenin. ...[a] stalemate between the ruling elite of a country and its population: the former could no longer rule, and the latter would no longer let themselves be ruled in the old way.”

Richard Pipes, *Foreign Affairs*, 1984
A Revolution Means

- Temporary breakdown of all institutions minimizes state capacity.
- A few policymakers have great freedom for half a year.

Policymakers need to act fast and focus on essence, but mistakes are inevitable.
“To wait means to fail.”

Mart Laar, former Prime Minister of Estonia, 1992-94 and 1999-2002
2. Why Did Market Reform Succeed?

- Enough was done in the brief window of opportunity in 1991-92 to secure the market economy.

**BUT**

- Initial economic results poor because reforms insufficient.

- Financial crash cleansed the market economy and completed financial stabilization.
2. Why Did Market Reform Succeed? Sound Policymaking

A Brief Window of Opportunity of “Extraordinary Politics”

- IDEA: Radical market reform
- Parliamentary support received
- Reform Government appointed, Nov. 1991
- Policy actions elaborated
- Implementation, Jan. 1992
Substantial Deregulation

EBRD transition index, 1990–2006

0 = low          1= high
Fast Privatization

% of GDP from private sector

Sources: EBRD
Frightful Budget Deficit Led to Financial Crash in 1998

Sources: EBRD
Budget Consolidation through Sharp Expenditure Cuts

Sources: EBRD
GDP Growth Bounced with Subsidy Cuts

Sources: EBRD, IMF World Economic Outlook
A Dynamic Market Economy since 1999

1. Critical mass of market reforms and privatization
2. Conservative macro policy
3. But minimal reforms since 2003

6.7 percent GDP growth a year
3. Why Did Democracy Fail?

- No concept
- No program
- Therefore, no early democracy building
- Old, unrepresentative parliament survived for too long and stunted party development
- New constitution: Excessive presidential powers
- Putin chose authoritarian rule
Yeltsin’s Greatest Mistake
Russia’s Authoritarian Reversal Was Not Inevitable

Source: Freedom House
4. To Understand Putin
Putin 2000-2003: Authoritarian Reform

- Second Chechnya War
- Media control
- Recentralization of power from regions
- Tax reform
- “Dictatorship of law”
Putin 2004-07: Pure Authoritarianism

- Yukos confiscation and renationalization
- Reinforced authoritarianism and deinstitutionalization
- Acceptance of rising corruption
Putin’s Future: He Has to Stay in Power

1. Personal authoritarian rule rarely survives a succession because no real institutions are left.

2. He is widely accused of grand larceny and needs all immunity he can get.
Political Instability

- Putin has betrayed all his KGB friends by selecting Dmitri Medvedev.
- Either Putin purges them soon or they are likely to instigate a coup against him.
Putin’s Choice: Back to Nicholas I

- Overcentralization of personal power
- Ruling through the secret police
- Increasing repression as is necessary
- Anachronism!
5. Russia’s Future
Future Outlook

- High economic growth
- Macroeconomic policy wavering
- Corruption aggravated
- Political uncertainty
Many Growth Drivers

1. Remonetization M2/GDP should double
2. Huge profit in GDP: 37 percent in 2005
3. 68 percent of Russian youth go to university—more than in the European Union.
4. The number of enterprises rise by over 7 percent a year

Investment no driver, but reasonable
Far Too Little Money Supply Allows Releveraging, 1999 and 2006

M2 in Percent of GDP, end year

Euro area
Ukraine
Russia

1999
2006
More University Education than in European Union, close to United States, 1991 and 2004

5 Million Russian Enterprises, Rising by 7 percent a year (in millions)
Economic Worries

- Renationalization: Private share of GDP from 70 percent of GDP in 2004 to 65 percent in 2007
- Top-level corruption rising
- Overheating: Inflation rising
- Energy production stagnating
Severe Corruption, Getting Worse

Systematic Corruption

- Corporate raiding by law enforcement
- Extortion of major private companies
- Concentration of vast fortunes of top KGB men from St. Petersburg

How much can they steal without damaging the economy?
High Inflation Rising Again

Inflation (CPI), % chg. over year

- 1999
- 2000
- 2001
- 2002
- 2003
- 2004
- 2005
- 2006
- 2007

Chart shows the percentage change in the Consumer Price Index (CPI) from 1999 to 2007, indicating a rise in inflation again over this period.
Causes of Rising Inflation

- Loose monetary policy
- Declining fiscal surplus
- Large capital inflows
- Current account surplus (declining)

Politics: No tightening likely before March—Inflation 15 percent?
Fiscal and Current Account Balances: Strong but Declining

Source: JPMorgan
Oil and Gas Production, 1985–2006

Source: BP Statistical Review of World Energy, 2007; UBS
Russia’s Future: Democracy

- Too rich, pluralist, and educated to be so authoritarian (Lipset)
- Only source of legitimacy: economic growth and stability
- Corruption main issue in all democratic East Central European elections

Renewed democratization likely
Conclusions

1. Too great a contradiction between sound economic development and anachronistic political system.
2. Russia’s market economy seems secure.
3. A new wave of democratization is likely.
What Should the West Do?

1. Promote economic integration: Admit Russia to the WTO and OECD!
2. Do not count on political stability!
3. Tell the truth!