

Lessons from Russia's Experience with Market-Oriented Reform

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What does the Russian experience with reform teach us about transitions from state to market-based economies? Several scholars have argued that the reform program upon which Russia embarked in late 1991 was itself sound, but the problem was that the reforms were not implemented quickly or comprehensively enough--the medical advice was appropriate, but the patient, alas, was too incompetent or weak-willed to follow the advice of the doctors and take the medicine as prescribed. However, given the severity of the economic crisis in Russia, it behooves us to consider the argument that it was not the lack of implementation of reforms or a lack of speed that ruined the reform effort. Rather, the failure of Russian economic reform is the result of a fundamental misunderstanding of the nature of the post-socialist state, and a consequent inattention to the development of institutions necessary for supporting a market economy. In short, we gravely misunderstood the patient.

Market Complexity and the Role of the State in a Capitalist Market Economy

If we accept that under communism the state officially controlled nearly all political and economic activity, then the introduction of markets--which would play a major role in the distribution of goods and services--necessitated taking certain functions away from the state. Further, if we understand that state functions are not discrete units that can be seamlessly added or subtracted, then we would conclude that the question of what to do with the institutions and actors that comprised the communist state was at the heart of the debate over any type of "reform" in the post-communist world. During Russian economic reform in the early 1990s there was widespread agreement on the first proposition, but much less on the second. Nearly everyone agreed that certain functions needed to be taken away from the state, but many in reform circles found the question of state-building irrelevant, since they assumed that the right economic system might alone promote desirable political institutions.

The majority of those considered reformers in Russia reasoned that the only way to rectify the weaknesses and problems of the Russian state was to concentrate as much as possible on constructing the proper economic system. Neoliberal Russian reformers recognized that some economies have functioning states, but they argued that those states function well because of the existence of capitalist markets and private property. Therefore, reformers reasoned that the remedy for a weak or problematic state, like

Russia's, could only be a laissez-faire approach--that is, the introduction of markets and private ownership without explicit attention towards developing political institutions (including, remarkably, the development of a legal system).

Unfortunately, what came to define the Russian reform program was not so much the emphasis on efficiency or markets, but rather a simplistic view of markets and states. This view appreciated neither the complexity of and relationship between real, existing markets and states in capitalist economies, nor the legacy of Soviet-era state institutions. The reforms in Russia can be understood as destatization--a set of policies aimed against the development or support of state institutions for governing the economy. Neoliberal reformers treated the Russian state as simply an undifferentiated source of inefficiency and corruption that must be dismantled. By abolishing state institutions and regulation of the economy to as large an extent as possible and by creating private property, reformers argued that markets in Russia would be free to emerge, bringing with them efficiency and all other positive aspects of a capitalist market economy. Moreover, Russian reformers used the emphasis on free markets and private property to ignore the growth of corruption and illegal activity in private economic transactions, and incompetence and weakness in government regulation of the economy.

A central problem with this neoliberal conceptualization of state and market was that it precluded consideration of several issues that were crucial to the implementation of economic reform. The emasculation of certain state functions coupled with strategic alliances that privileged particular groups in society enabled reformers to believe that the problem of state institutions could be ignored in the short term without consequence. Perhaps more importantly, reformers embraced a set of neoliberal assumptions regarding political and economic development which suggested that economic must precede political reforms. Therefore, Russian reformers did not care to ask, much less answer, the question of what kind of state transformation would be necessary for economic reforms to succeed. In reform circles there was minimal deliberation regarding the existing configuration of Soviet-era state and social institutions. They did not seriously consider the impact that communist political institutions (including, for example, elite networks) would have on reform. The transition from a Soviet system to a Russian national economy situated in a global capitalist context required the elaboration of novel state institutions and mechanisms of governance. But the development of such governance structures was impeded by the policies of destatization and neoliberal inattention to state and market complexity.

In order to replicate the benefits of Western market economies in post-socialist contexts, it was necessary to think seriously about how markets in capitalist countries actually work. The superior ability of markets in handling economic problems could never have been reproduced in the post-socialist Russian context simply by the quick transfer of outdated but ideologically appealing metaphors. To argue for complexity in market design is to appreciate the major theoretical currents in economics; it is not an argument against markets. By offering a very simple market model, the neoliberal reform program in Russia failed to deliver the expertise and understanding of complexity in market institutional design that is necessary for a functioning market economy.

As an example, we can consider the process of liberalization. Because it entails structural reforms (including the introduction of markets by freeing of prices and trade and cutting government subsidies), liberalization is necessarily concerned with establishing some kind of role, be it limited or expansive, of the state in the economy. However, liberalization in Russia proceeded with scant attention to the development of state institutions--and the disastrous consequences are well known today. On the one hand, a plethora of unfair predatory state practices went unchecked. On the other hand, liberalization entailed not only the freeing of prices and trade, but also dismantling of certain state institutions that were necessary for the monitoring of economic transactions. By not giving the state the tools to monitor the market (in the form of functioning regulatory institutions), the liberalization of prices and the legalization of any kind of trade activity contributed to criminalization. It is important to underline that the call for attention to institutions and a reformulated role for the state in the economy is not a retreat from marketization. Rather, the experience in Russia teaches us that real marketization requires establishing the parameters of state institutions.

Political Process

A second major lesson of the Russian marketization experience is that the political process of reform has important economic consequences. Unfortunately, the reform program began in Russia with the presentation of overly sharp distinctions in the characterization of reform possibilities. The rhetoric of reform consisted of a rather stark dichotomy between a fully regulated centralized state-run economy on the one side, and an idealized laissez-faire market on the other. This dichotomy made any suggestion of government regulation or support for production seem anti-stabilization and liberalization. This kind of analysis was based on simplistic models of both the state and the market, and it supported the reductionist claim that there was only one possible path for successful economic reform in Russia.

The confidence that reformers had identified an undeniable single path towards economic reform made the use of undemocratic means--specifically, rule by executive decree--not only palatable but preferable. Reformers applauded the behind-the-scenes approach to policymaking (conducted by a small group of officials selected by the president) because they claimed that so few people in Russia understood what should be done. Those outside of the government were considered either intellectually ill-prepared or ideologically tainted.

The use of executive decree and the side-stepping of parliament in policymaking bolstered reformers' sense that they possessed a monopoly on good economic advice, but it also fueled a fear that the ignorant masses or the communists might organize to stop the reforms. Due to this threat of organized opposition, reformers reasoned that they needed to make strategic alliances with certain groups in society. Conveniently, this logic allowed reformers to present their seemingly corrupt support for certain groups as being unavoidable to secure the passage of the reform program. Some reformers used the same argument to justify making insider deals with industrial elites. By denying the possibility

of alternative programs, such an argument implies that reformers cannot be criticized for selling out to insiders.

In the Russian experience, the presentation of a single path for marketization, the use of executive decrees, and the granting of unfair concessions to groups progressed rather quickly towards support for corruption as a means to achieve the goals of economic reform. This development strongly suggests that the political means used in carrying out economic reform are important, and that the idea of "marketization by any means necessary" should be looked upon with great skepticism.

Comparisons with Eastern Europe

A final consideration in evaluating the reform program in Russia is comparison with the reform programs in other post-socialist countries. Specifically, one has to be able to explain the variation in success of the neoliberal approach in other Eastern European countries. In many ways Poland--which exemplified the neoliberal "Shock Therapy" or "Big Bang" approach--was the model for Russian economic reform. The relative stability as well as positive growth rates in Poland in comparison with the dismal situation in Russia invite the question of how Poland was able to succeed where Russia failed.

It is worth considering whether the crucial variable explaining success in Eastern Europe may have been the pre-reform configuration of the states and markets, including the specific type of institutions in each country. For example, the existence of private trade, small businesses, and uncollectivized agriculture, as well as the use of money distinguished Poland from Russia at the time of reforms. Moreover, the Russian economy was far more oriented towards large extractive and defense-related industries. There were also significant differences in the institutions of civil society. Poland, for example, had a strong Catholic church and potent trade unions in comparison to Russia. These factors not only suggest a different type of economic and civic structure, but these variations in market and social institutions also necessitate a different set of state institutions for governing or overseeing the economy and society.

Moreover, it appears that the variables which might explain success in Eastern Europe were largely given to reformers for free; hence neoliberals erred in concluding that success in places like Poland was due to their simplistic, rigid market-as-opposed-to-state program of fast liberalization and stabilization. By recognizing the important differences in the configurations of states and markets at the time of reform--which include the level of direct state involvement in the economy through government organizations as well as the level of involvement through the oversight of non-state institutions and organizations--we can better specify and understand the conditions under which certain reform policies work.

Conclusion

Obviously the question of institution building is a difficult one. However, the problem of post-communism was, by definition, how to reformulate the state. The empirical evidence from most countries in the world suggests that there is no easy answer to the challenge of building democratic governments or markets. Yet Russia's experience confirms the now unavoidable conclusion that successful states and markets work in concert with one another. Limited government intervention is not synonymous with a weak state, and inefficient government subsidies are not equivalent to competent regulation. By conflating institutional strength with state size, economic reformers misread the central puzzle facing Russia and proved ill-equipped to chart Russia's course through marketization and democratization.

The principal reason for the lack of success of the neoliberal program in Russia was the wholesale neglect of the role of the state and the consequent inattention to the building of institutions necessary for supporting a market-oriented economy. This experience implies that if market-oriented reforms require attention to the building of state institutions, then successful economic reform must proceed with respect to the political institutional context. The answer to what type of reform should be undertaken will depend on the starting institutional and material conditions. It is only with an accurate and specific understanding of the context in which reform is to take place that an appropriate set of policies can be conceived. Again, this is no call to "exceptionalism;" rather it is a call to greater specificity in the comparative analysis that informs policy choices.

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