Russia's Informal Revolution

Paul Craig Roberts

Oleg Bogomolov reports, correctly I think, that the key to a sound monetary system and transition to a market economy is the privatization of the wealth that is in possession of the state. He also reports, again correctly, that prior to price liberalization, property should have been privatized, monopolistic structures demolished, foreign trade liberalized, the budget deficit reduced, and the money supply controlled.

He then reports, again correctly, that there was no time to do these things, no effective executive authority to carry them out, that ñumerous prices became free de facto in advance of official reform policies, and that privatization is also following a de facto course in which state property is simply seized by authorities and lower-level economic bodies. The kind of privatization that Bogomolov recommends, and that I also favor—consisting of large-scale gifts to the people of apartments, land, and shares in enterprises converted to joint stock companies, as partial compensation for the enormous material losses of the population—is blocked by the restraint of the Russian government at all levels, because those in control of government understand that the sale or distribution of state property among the population diminishes their power.

The Case for Optimism

Faced with the facts reported by Bogomolov, we can become pessimistic or optimistic. Let me make the case for optimism. The transition to capitalism in Russia is too big a problem for politics. Informal social processes will lead the transformation, and official state-led reforms will lag. Considering the weakness of the government, there is a good chance that its role will be to follow along

---

Cato Institute, Vol. 12, No. 3 (Winter 1993).

The author is Chairman of the Institute for Political Economy and a Distinguished Fellow at the Cato Institute.

afterward, giving its sanction to most of the transformation and overturning only those parts that are most strikingly unfair. This means a lot of turmoil and many false crises along with some real ones while things sort themselves out.

Another reason for optimism is that Russian economics, as practiced by Bogomolov, is a great improvement over the old Soviet economics. Bogomolov's analysis embodies the role of expectations in inflation and hyperinflation. Unlike some of the Western advisers to the Soviet and Russian governments, he understands that so-called stabilization measures directed at the "ruble overhang" merely restricted the effective demand of the population and wiped out its savings, thus undermining the motivation for productive and conscientious work and financing for entrepreneurs. He understands, better than the bureaucrats in the IMF, the Congressional Joint Committee on Taxation, or the U.S. Treasury, that the tax measures designed to address the Russian budget deficit are a package of disincentives that will suppress the entrepreneurial and labor activities that the economy most desperately needs. He arrives at the supply-side prescription that the most optimal policy for the growth of tax revenues is the expansion of production. Unlike Western development economists, he understands the critical role of foreign investment. Unlike so many of our own professors, he understands that it is necessary to strengthen the authority of the state as a representative and defender of the interests of the population, by which he says he means the provision of sound money and guarantee of economic freedom.

Eliminating the Source of the Inflation

Where then can we criticize this free-thinking Russian? I found two places. He urges a commodity-backed ruble to anchor the monetary system. I do not object to a commodity-backed currency. Rather, the problem with the ruble is that too many are being printed in order to finance state deficits. As long as there are state deficits that must be financed with money creation, a new currency would be subject to the same inflation—commodity-backed or not. The design of a new currency is a big challenge that would divert effort, perhaps without effect. It would be better to privatize and, thereby, eliminate the state deficits that are the source of the inflation.

Bogomolov recommends that the West back a new Russian currency, and he suggests that the West tie its assistance in stabilizing the Russian monetary system and ruble convertibility to an opening of Russia to foreign investors. Again, a currency cannot be stabilized if it has to be printed in great quantities. Moreover, tying foreign aid to foreign investment could be politically risky for a weak government with a nationalistic opposition, who could then accuse the government of selling out the country to foreigners.

In fairness to Bogomolov, he came up with these proposals because he sees inaction in large-scale de jure privatization and settled on strengthening the ruble as the only feasible plan. There is no doubt that Russia and the other republics face enormous challenges. But we should remember that these peoples or their ancestors survived Lenin, Stalin, forced collectivization, state-inflicted famine on more than one occasion, World War II, paranoid leadership, and 75 years of the worst economy the world has ever seen. With all this under their belts, I think they can survive the transition to private property and a market system. However threatening a free-price system might seem to some, it is nothing compared to the gulag.

Informal Processes of Transition

We should keep in mind that there is a great difference between the official reform model and the informal processes of transition. The Russian government may, or may not, be following the Polish model, but the informal privatizations, evolution of de facto private property rights, day-to-day transaction prices, and so forth are moving on their own paths. In a sense Russia is a wide-open frontier society. People who have the confidence to act are acquiring rights by exercising them. Bogomolov reports that the central government lacks power and that its policies are wrong, and he sees this as a problem. But it might be an advantage. If the policies are wrong, it is just as well that the government lacks the power to implement them.

We have heard a variety of complaints, which paint a hopeless picture but look less disturbing when put in context. For example, the Russian budget deficit is said to be 14 percent of GNP, which puts it in the same league as the Italian one, and Italy remains a pleasant and entertaining place to live. Russian monetary policy is said to be impaired because the ruble is supplied to most of the former Soviet republics. However, the dollar is supplied to the whole world, and the United States enjoys corresponding reserve currency privileges. Official statistics show collapsing Russian GNP, but these data do not measure the unofficial economy or the more efficient use of resources as they are shifted from meeting gross output targets to real needs. The monetary situation is deplorable, but South American countries have lived with higher rates of inflation for longer periods of time, and even demoralized POWs fashioned a monetary instrument out of cigarettes to facilitate trade. Russia will do no less.

Even in its heyday, the Soviet economy never worked. People learned long ago from necessity how to get around it, and a large percentage of the resources has always been allocated unofficially. This unofficial economy is the basis for the new economy, and it is misleading to see the decline in official production as collapse if unofficial production is growing.

Avoiding a New Bureaucratic Class

In our efforts to aid Russia and the other republics, we should be careful not to empower a new bureaucratic class that would create incentives that would divert entrepreneurs away from profit-seeking into rent-seeking activity. The history of our foreign aid to the Third World is largely one of subsidizing the rent-seeking behavior patterns of the mercantilistic economy. It would be better not to help the Russians at all than to underwrite a rent-seeking system.

Monetary Stabilization in Russia: What Is to Be Done?

Nikolai Petrakov

Unfulfilled Expectations for the First Steps of Russian Reform

After the prolonged stalling of the Nikolai Ryzhkov government and Valentin Pavlov's half-hearted reforms, Boris Yeltsin decided to bet on the "tough boys" of the Yegor Gaidar team. The Gaidar reform plan attempted to copy, as precisely as possible, the Polish shock therapy option. Price deregulation was seen as the key to the elimination of the budget deficit, to monetary stabilization and ruble convertibility, and to the structural reform of the economy—not just a key anymore but a sort of magical "Open Sesame" for every lock on economic progress.

It became increasingly clear that the calculations of the young Russian theorist-reformers were not proving accurate for two reasons.

First, the price hike turned out to be far steeper than Deputy Prime Minister Gaidar supposed. He expected prices to increase by 2.5 or 3 times in January and February 1992. Yet typically, in the first month prices increased tenfold.

Second, the Russian government believed that following the price increases, the supply of goods would increase drastically and store shelves would be filled. These hopes were based on the following. The government had announced the price liberalization two months in advance and expected producers and traders to stock up on goods. In addition, there were hopes that business activity would be quickly energized in all spheres, and also that demand would fall with the decline of purchasing power.

Cato Journal, Vol 12, No. 3 (Winter 1993).

The author is Director of the Institute of Market Economics of the Russian Academy of Sciences.