Anders Aslund, in his article "How Russia Was Won," has written another remarkable piece, trying to explain that the recent "success" of Russia is due to its following more faithfully the advice of the International Monetary Fund and the U.S. Treasury Department -- just as the poor performance prior to that was due to its failure to follow that advice sufficiently faithfully. He argues that the growth of the country since the 1998 financial crisis bears testimony to the fact that he and the IMF are correct, and that the interpretation provided in my recent book "Globalization and Its Discontents" is wrong.

Russia's performance since the crisis has been impressive -- but the country's GDP is still almost 30 percent below where it was at the beginning of the decade. At 4 percent growth per annum, it will take Russia another decade to get back to where it was before the beginning of transition. Remember, the move from communism to a market economy was supposed to increase economic prosperity. A two-decade transition depression/recession, during which poverty and inequality increased enormously, while a few have become very wealthy, can hardly be called a victory. And the longer run prospects are far less rosy than Aslund would suggest: With investment a mere 10 percent of what it was in 1990, even if that investment is better allocated, how can growth be sustained? Russia did finally achieve a modicum of success when it broke away from the IMF program that Aslund supports so strongly. The IMF did not want Russia to devalue, and provided billions of dollars to help it avoid devaluation. The high exchange rate and high interest rates that were necessary to sustain it in the absence of capital controls had strangled the economy. Before the devaluation, I recall conversations with the U.S. deputy treasury secretary -- the United States effectively dictated IMF Russia policies, so his views were important -- together with some top Russian academicians. These academicians, as well as many economists at the World Bank, thought that there was excess capacity, and that the IMF/U.S. Treasury policies were destroying the economy.

The IMF and U.S. Treasury worried that any change would restart inflation, that there was little or no excess capacity. This was a remarkable confession: Evidently, they believed that their policies, in the space of just a few years, had destroyed more than 40 percent of the country's capacity, something that no war had ever done. They shunted aside micro-data from Russia which showed that there was in fact excess capacity, just as they ignored the World Bank's analysis of debt dynamics, which showed that the proposed huge new IMF loans -- even if not misused due to corruption -- would not succeed in restoring growth of the economy and would only leave the country more in debt. A few at the top of the IMF, and especially the U.S.-appointed first deputy
managing director, actually seemed to convince themselves that the programs would work, although to their credit, many in the IMF, including its chief economist, seemed to recognize that this was simply another example of lending motivated more by politics than economics.

The results were as I, and the World Bank economists, had predicted: The 1998 bailout did not work, the devaluation did work. There was enormous excess supply; import substitution started to take place, even in the midst of the turmoil. Imports in the year after the crash were down nearly 50 percent relative to the year before the crash, and while some of this decrease reflected the decline in the overall economy, much of it was due to a switch from buying foreign food, clothes and other goods to Russian-made ones. Later, of course, higher world oil prices gave further impetus to the economy. Profits generated provided funds for expansion, even when the banking system (which had never done much of what banking systems are supposed to do -- i.e., provide finance for the creation of new enterprises and the expansion of old) was slow to recover. Capital controls were imposed, and instead of looking for the best opportunities for investment in New York, those with money looked for opportunities at home.

Yes, the market economy can provide incentives for wealth creation. But unfortunately, under the preceding years of IMF programs, the market economy with high interest rates, illegitimate privatizations, poor corporate governance and capital market liberalization had provided incentives for asset stripping. Growth was caused by the change in the economic environment, a change that Russia made for itself, over the objections of those like Aslund and the IMF.

Aslund has another interpretation: The crash was a wake-up call; the new reformist parliament elected in December 1999, in tandem with the reformist administration of President Vladimir Putin that took over in 2000, lowered tax rates, undertook judicial reform, legislated private ownership of land, adopted new banking laws -- in short, did all the reforms that they should have done, and hey presto, growth took off, just as the reformers had said it would all along.

There are two problems with this interpretation. The first is that growth began before these reforms were in place. Even with the turmoil of default and devaluation, even with the usual 12 to 18-month lag in impact of devaluation, Russia was growing by 5.4 percent by the end of 1999. And second, there can be a long gap between legislation and meaningful reform.

Some of the reforms, like those in taxation, were important mainly because they added to the dynamism already present in the economy. (At the overvalued exchange rates, before oil prices started to increase, even with tax reform, there would have been no profits in the critical oil sector to tax. Any squeezing of that sector would have simply further dried up funds for investment.) If Aslund's story made any sense, as the reforms actually get implemented and solidified, growth should be taking off, not declining -- especially given the high oil prices. Analyses that begin by looking at economics rather than ideology and wishful thinking can explain the decline before 1998, the robust growth afterward, and
the more recent slowdown. There has, for instance, been a real exchange rate appreciation -- and just as one would have predicted, it has had adverse effects on growth.

Aslund's ideology shows through most clearly in his final passage. He argues that the form of privatization does not matter and asserts that "no strategic restructuring appears possible before its an enterprise's privatization." These were the central tenets of the IMF/U.S. Treasury program. But they were wrong. Theoretical and empirical research at the World Bank and elsewhere, including the examples of Poland and other countries that took different approaches, has shown that restructuring is possible before privatization; that how privatization occurs does make a difference, both in the short and long run. Privatization without good corporate governance typically does not lead to faster growth. It does, however, lead to a whole host of problems.

In the long run, we should be concerned not just with the pace of economic growth but with the kind of society that is being created. To Aslund, evidently, the concentration of ownership in Russia is of no concern, so long as it generates growth. Before the so-called reformers, there was another vision of a market economy based on greater equality, using the power of markets to bring riches not just to a few but to all of society. That the Russian transition did not achieve this is perhaps not a surprise -- it was nowhere in the vision of these reformers. But their view of economics was so tilted, so ideologically driven, that they even failed in the narrower objective of bringing about economic growth. What they achieved was a remarkable decline. No amount of rewriting history will change this.

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