

The Ruin of Russia

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No rewriting of history can change the fact that neo-liberal reform produced undiluted economic decline.

Ten years ago this month, Russia's parliament, the duma, was seeking to impeach President Boris Yeltsin, initiating a time of stalemate and struggle that ended seven months later when Yeltsin ordered tanks to fire on the duma's headquarters. Yeltsin's victory settled who ruled Russia and who would determine economic policy. But were Yeltsin's economic policy choices the right ones for Russia?

The move from communism to capitalism in Russia after 1991 was supposed to bring unprecedented prosperity. It did not. By the time of the rouble crisis of August 1998, output had fallen by almost half and poverty had increased from 2% of the population to over 40%. Russia's performance since then has been impressive, yet its gross domestic product remains almost 30% below what it was in 1990. At 4% growth per annum, it will take Russia's economy another decade to get back to where it was when communism collapsed. A transition that lasts two decades, during which poverty and inequality increase enormously as a few become wealthy, cannot be called a victory for capitalism or democracy. Moreover, the longer-run prospects are far from rosy: with investment a mere 10% of what it was in 1990, even if that investment is better allocated, how can growth be sustained?

IMF-style neo-liberals are now trotting out an interpretation that amounts to a belated declaration of victory. The pre-1998 period of economic decline, on their view, reflected a stalled transition process, whereas the rouble crisis finally jolted the authorities into action, with recovery following implementation of far-reaching reforms. But the real explanation lies elsewhere - and is much simpler. Until 1998, the rouble was overvalued, making it impossible for domestic producers to compete with imports. The IMF did not want Russia to devalue, and it provided billions of dollars to prop up the exchange rate. The IMF and the US Treasury worried that any change would restart inflation, because there was little or no excess productive capacity.

This was a remarkable confession: these officials evidently believed that their policies had wrecked nearly half of Russia's economic capacity in the space of just a few years. They shunted aside micro-level data that showed that there was in fact excess capacity, just as they ignored a World Bank analysis showing that fresh IMF loans would not restore economic growth, but would only leave the country deeper in debt. These results were predictable: the 1998 bailout did not work, but devaluation did. It turned out that there was enormous excess capacity, and import substitution soon began, even in the midst of financial turmoil. Imports plummeted by nearly 50% in the year after devaluation, as consumers were forced to buy Russian-made food and goods.

Later, higher world oil prices provided a further boost to the economy, generating funds for investment and expansion. Profits generated provided funds for expansion. Capital controls were imposed and domestic investors looked for opportunities at home instead of in New York or Cyprus. Yes, the market economy can provide incentives for wealth creation. Unfortunately, under the preceding years of IMF programmes, the market economy - with high interest rates, illegitimate privatisation, poor corporate governance and capital-market liberalisation - provided only incentives for asset-stripping. Growth was caused by the change in the economic environment, a change that Russia made for itself.

The reformist parliament elected in December 1999 in tandem with President Vladimir Putin's reformist administration reduced tax rates, overhauled the judicial system, legislated private ownership of land and adopted new banking laws. These are positive reforms, but they do not explain the burst of post-crisis growth, which began before any of them were passed, let alone put in place. Indeed, even with the turmoil of default and devaluation, and despite the usual 12- to 18-month lag in the impact of devaluation, Russia was growing at 5.4% annually by the end of 1999. In the long run, we should be concerned not just with the pace of economic growth but with the type of society that is created. To Russia's so-called reformers, the enormous concentration of ownership in Russia that emerged in the 1990s, is of no concern, so long as it generates growth.

But there is another vision of a market economy, one based on greater equality, which uses the power of markets to bring prosperity not just to the few but to all of society. That Russia's transition did not achieve this is not a surprise. That goal was not a part of the reformers' vision. The great paradox is that their view of economics was so stilted, so ideologically driven, that they failed even in their narrower objective of bringing about economic growth. What they achieved was undiluted decline. No rewriting of history will change this.