

Russian economy



Why did it prove so difficult to stabilise the Russian economy in the initial years of post-communist transformation?

The Union of Soviet Socialist Republics was dissolved by the Russian, Ukrainian and Belarusian leaders on December 08, 1991. It was replaced by Russia and fourteen other newly independent states(1). This marked the start of a hard period for the Russian economy as it was decided to make a transition from a planned to a market economy not only in Russia but also in most of the ex-soviet countries. The main problem of transition was finding the right path for this transition to take and reach the main goals of the transition: macroeconomic stabilization and economic restructuring within a market economy. This essay will look and evaluate not only this but also other difficulties which contributed to the hardship of stabilizing the Russian economy in the initial years of post- communism. We shall look at the state in which the Russian economy was when the USSR was dissolved. Looking at the policies used in the transformation we will see which particular spheres had problems which caused so many difficulties to this process in the Russian economy and draw conclusions supported by observations.

Introduction

The economic transition theory of a planned economy being reformed to a market economy was quite different before the collapse of the Soviet Union. The 1990s produced new literature about this transition based on real life observations of countries in different situations. Russia is quite an exceptional case; it is one of the largest countries in the world and it was the main power in the USSR also its political constraints differ from other countries. So its transition must differ greatly from those of the other ex-communist countries. This brings us to the question of what kind of transition

<https://assignbuster.com/russian-economy/>

should be applied to the planned economy in the case of Russia? Rapid growth of “ shock therapy” is based on the quick establishment of functioning markets, quick restructuring of enterprise, and the creation of conditions for new business set-ups, which in turn creates high demand for market institutions. An alternative to “ shock therapy” is the “ gradualist approach” to liberalization and privatization. The “ gradualist approach” allows for a more balanced structural adjustment(2). The components of transition were typically classified in four major dimensions. First the Microeconomics of transition focused on creating markets and market price signals throughout privatization. Second, the macroeconomics of transition centred on creating a money-financial system, specifically a financial infrastructure and developing new a new fiscal role for the state, through the budgetary process to guide macroeconomic performance. Third, major emphasis has been placed upon international economic integration, specifically on new trading arrangements and policies. Finally, transition has had to consider the safety net, or the infrastructure and policies for the provision of medical services, unemployment benefits, pensions, and the like which earlier were handled quite differently(1). The approach to transition that Russia has chosen plays a major role in understanding the difficulties of stabilizing its economy and importance of each of the four dimensions specified.

USSR legacy

We also have to look at Russia economy in 1991. It is quite important to understand in what condition was the Russian economy before the transformation. How the reforms of Mikhail Gorbachev have influenced the

initial conditions for choosing an approach to the transition. Perestroika and Glasnost were two most important reforms for restructuring and the Soviet system. We are more concerned with Perestroika because this reform was concerned with the economic system of the Union. With the Cooperative law of 1988 it allowed for the first time, since Lenin's New Economic policy a Private sector to establish itself in the economic system. The government rule over State owned enterprises was reduced and self governance of the enterprises was allowed. Nonetheless with the implication of this reform the government plan targets of 1986-1990 were retained, the orders to the enterprises were almost only from the government. Also due to the self governance wages were increased without a proportionate increase in productivity which signalled inflation danger. There was a great incentive to hide revenue from the government, this inflicted great damage to the state budget. Prices were also controlled and not determined by market forces. Foreign investment was also allowed but under a lot of restrictions. The crisis Soviet Union was facing was already beginning when Mikhail Gorbachev came to power. Gorbachev was convinced that the communist system could not continue to manage the economy and society in the old way, and he intended to achieve its modernization through perestroika. For him the aim was not to transcend the Soviet system but to achieve its reform (3). But due to the high level of control the government tried to impose on the newly obtained economic freedom in the system the reforms failed and by 1990 the Soviet Union was in deep crisis. The government lost control over the economy. Unprofitable enterprises burdened the budget with requirement for support by subsidies. With the growing sense of regional autonomy local governments hid taxes which also damaged the budget. During 1990-1991

industrial and agricultural output declined dramatically leading to almost 20% fall in GNP and national income. So we can conclude that the state in which the economy was before the economic transformation was very hard to handle and a difficulty itself for establishing a working market economy.

“ Shock therapy”

The breakup of the Soviet Union added more pressure on the Russian economy and contributed to already a great crisis. A decision had to be made on what kind of approach to use to the transformation of the planned economy to a market one. Boris Yeltsin and his cabinet decided to undertake the “ Shock therapy” or “ Big bang” approach, liberal economic policies which were used by the International Monetary Fund, the World Bank and the U. S. Treasury Department. Boris Yeltsin used the political situation at that moment to implement this approach. The political vacuum at the end of the planned socialist era provided an opportunity for change, if change is not implemented quickly, the downturn of the economy at the start of transition can result in discontent and resulting retrenchment(1). So we shall look at some of the four main dimensions mentioned earlier to see how the transformation did in the initial years and what the main difficulties were.

First let us look at the microeconomics of transition, privatization in particular. The privatizations first phase was called “ voucher privatization” with voucher being distributed to every one of the 148 million Russian men, women and children. These voucher’s could be used to buy shares of Russian companies or be sold a newly developed secondary market, which lets us to the assumption that people with greater wealth could acquire them and thus a greater share of a company. But the government still retained

parts of shares which allowed them to interfere in the decision making of the company. The second stage was to sell the remaining shares of enterprises were sold through investment tenders, cash auctions, or specialised auctions(1). This was a major opportunity for certain people with contacts, certain information about the selling of the stocks and access to financing. These “ insiders” could misuse their position and knowledge to obtain more profitable stocks and manipulate with their prices, thus accumulating a great amount of wealth. This led to a massive redistribution of income in the direction of greater inequality. The top 20 percent of highest earning household accounted for slightly more than 35 percent of the total income in 1991 compared to almost 50 percent in 1995(1). The difficulty of “ shock therapy” concerning privatization was the speed at which the new private sector was emerging. The number of work places in the state owned enterprises was diminishing and the work places in the private sector were increasing, but due to the differences in speed this process contributed to the already high unemployment. After the breakup of the Soviet Union regions which had only one industry suffered greatly from unemployment. The decrease of output due to decrease in demand (e. g. arms industry) called for a reduction in labour force. The process of privatization only made this more of a difficulty for transformation. Another issue concerning privatization were prices of goods, the lack of market forces drove these prices up after the government removed price controls. Combined with the money overhang inherited from the Soviet Union Russia this problem spilled over to macroeconomics of transition causing huge rates of inflation.

Since 1992, Russia's economic authorities have repeatedly attempted to control and lower the country's inflation rate. At times they achieved temporary victories. On three separate occasions, the monthly inflation rate was pushed down by eight or more percentage points. But on each of these occasions the success was transitory: within months the price level soared again. Against this background, the sustained tapering fall that began in January 1995 stands out(4). Such situation and the central banks mistrust of the reforms President Yeltsin implemented was itself a difficulty for the transition process. Another macroeconomic difficulty in the transition process was the issue of taxes. Market economies rely primarily on sales taxes and on payroll taxes and personal income taxes to collect revenues. The structure of Russian taxes in 1995 have shown that the major source of revenue were profit taxes and sales taxes also unusually very important special taxes, like export taxes or transportation taxes, which play relatively minor roles in the West. The state's inability to identify and measure personal taxable income was the problem. Record keeping on wages and income has been very poor, and enterprises have found ways to conceal payments to workers and employees. State tax collections have been severely damaged by the decline in economic output, by the fact that much economic output is underground in the so called " second market" and out of the reach of the taxing authority, by the ability of influential enterprise to bargain down their tax obligations, and by the general decline in tax disciplines(1). Federal tax collections have dropped sharply since the beginning of reform – from 17. 8 percent GDP in 1992 to 10. 1 percent in 1997. This collapse in federal revenues contrasts with a relatively stable trend at the regional and local levels. Between 1992 and 1997, regional

consolidated budget tax revenues (including local) actually rose slightly, relative to GDP, from 11.9 to 12.6 percent. Because of the weak federal collections, revenues of the consolidated budget – central, regional, and local budgets combined – fell from an estimated 29.7 percent of GDP in 1992 to 22.7 percent in 1997. And if revenues of federal extra budgetary funds such as the pension funds are included, the drop between 1992 and 1996 is almost 10 percent(4). The tax problem also contributed to the budget deficit which was already present before the collapse. Trying to deal with the budget deficit by increasing the money supply only sharpened the problem of inflation.

Raudona – Is wikipedijos, reikia surasti ir pakeisti citatomis is akademinio saltinio.

1. Kopijuota knyga
2. Natalja von Westernhagen, Systematic Transformation, Trade and Economic Growth (Developments, Theoretical Analysis and Empirical Results. Printed Physica-Verlag Heidelberg 2002, Printed in Germany
3. White S, Gitelman Z & Sakwa R (eds), “ Developments in Russian politics 6” (Palgrave 2005)
4. Without a map

Possible content/plan:

Transition: Theory, Policy and practice

Creating the Institutions of a Russian Market economy

The Macroeconomy : Institutions and policies

Russia's integration into the global economy

Changing Structure: Leading and Lagging sectors

Economic stagnation: a virtual economy?

Russia in the twenty-first century