

Russia's economy during yeltsin era



**ASSIGN
BUSTER**

Analyse the principle problems facing the Russian economy at the end of the Yeltsin era. How have these problems been tackled?

Abstract

The following dissertation will analyse the principle problems facing the Russian economy at the end of the Yeltsin era. In many respects these principle problems facing the Russian economy stemmed from the economic and political disintegration of the Soviet Union combined with how effectively or ineffectively the Yeltsin administration had attempted to deal with those problems. As will be discussed the principle economic problems that faced the Russian Federation in 1992 were daunting, and therefore it is not surprising that some of these problems remained unsolved and were bequeathed to the incoming Putin government after Yeltsin's surprise resignation at the end of 1999. Yeltsin had seemed to be Russia's political saviour in August 1991 when he led the resistance to the attempted coup of Soviet hard-liners against Gorbachev. The failure of that coup inevitably accelerated the demise of the Soviet Union. However, the Russian economy would prove much harder to tackle than desperate Soviet generals and KGB chiefs. ^[1] The principle problems of the Russian economy can be arguably traced back to the inefficiencies of the Soviet Union's command economy and its massive military expenditure during the Cold War. These economic problems accelerated the demise of the Soviet Union itself and made it difficult to make the economic transition to capitalism without major economic implications. ^[2]

The Soviet Union for all its economic faults had at least provided a basic standard of living, which meant that none of its people starved or were in severe economic distress. This was despite a stagnant economy, although its economic stability crumbled with remarkable speed. For much of the Yeltsin era the Russian economy could not match the basic living standards of the old Soviet Union for many of its citizens. ^[3] It could be argued that the transition to capitalism contributed to the worsening of the principle problems outlined below, and that ill thought out economic policies since have made it more difficult for those problems to be effectively tackled during and after the Yeltsin era.

Among the main themes of this dissertation is that the Yeltsin government did not have a consistent set of economic and political policies to solve the principle problems of the Russian economy, which in turn hampered the effective tackling of those problems. The so called young reformers led by Yegor Gaidar and Anatoly Chubais had the most thought out strategies for the Russian economy, yet they did not have a constant control over the government's economic policy throughout the Yeltsin era. ^[4] Besides not all the economic strategies advocated by the young reformers proved to be effective once the Russian government put those strategies into practice. The ways in which all the principle problems of the Russian economy at the end of the Yeltsin era were all interconnected are arguably obvious and apparent. To a certain extent it will be argued that Boris Yeltsin himself did not help the Russian government to tackle the principle problems of the Russian economy. The link between principle problems in the Russian

economy and political ones plus social factors will be discussed when and where appropriate.

This dissertation will seek to examine the reasons for the Russian economy taking over a decade to achieve real growth, despite following the policies that it was advised would promote stability, liberalised and privatised economy. This dissertation will attempt to analyse whether the economic transition achieved anything at all to justify an estimated 47 % decrease in living standards between 1991 and 2000. How many Russians believed that the detrimental effects of the principle problems of the Russian economy at the end of the Yeltsin era could have been averted or tackled earlier? ^[5]

When Boris Yeltsin assumed the presidency of the Russian Federation it was still part of the Soviet Union and not even a sovereign state in its own right also it did not have control over economic policy. Yeltsin presided over the dismantling of Communist control in Russia, yet he found it very difficult to construct capitalism from virtually non-existent foundations as any form of capitalist economic activity had been illegal for much of the previous 75 years after the Communist Revolution. ^[6] By the time Yeltsin left his presidential office, the Russian Federation was a fully independent state that nominally, if not completely become a liberal democracy with a capitalist market economy. However, the dual Russian transitions to liberal democracy and capitalism from an authoritarian Communist State proved difficult and many have argued that those transitions remain incomplete. The incompleteness of the transition to capitalism and the political and economic make up of the Russian federation had a strong influence upon the principle

problems facing the Russian economy at the end of the Yeltsin era. Russia had been used to authoritarian government with state controlled central planning for the economy so the process of liberalisation had been uneven and had unwelcome social and economic consequences across Russia. The legacy of misguided Soviet economic planning took much effort and a great deal of suffering for the poorest sections of the Russian society to break, it seemed to help a minority of Russians make their fortunes, whilst leaving the rest to fend for themselves. In Russia the correlation between political and economic weaknesses arguably helped to make the post-communist economic and democratic situation imperfect and even corrupt. ^[7] The move to bring capitalism to Russia in less than a decade was as revolutionary as Stalin's attempts to achieve industrialisation during collectivisation, yet the opposite aims of privatising the economy. The aim of the Yeltsin government to bring capitalism was a sensible notion, yet the ways that it was implemented caused controversy as well as arguably increasing the impact of the principle problems that afflicted the Russian economy at the end of the Yeltsin era. ^[8]

Decline and signs of recovery 1992 - 1998

The initial bout of economic shock therapy administered in 1992 brought about hyperinflation, the closure of many factories and enterprises, which led inevitably to mass unemployment. Gaider and the other young reformers in the Yeltsin government had to end state subsidies to factories and introduce the lifting of price controls at one go rather than to introduce reforms gradually. It was harsh economic medicine for a country burdened

with the consequences of communism's profound economic and political failures, although Yeltsin did not have the political strength or motivation to carry out shock therapy as extensively as Gaider and the other ' young reformers' had originally intended. Through much of the 1990s the young reformers and the richest entrepreneurs known as the oligarchs competed for political influence and power, whilst contending to gain control of the Russian economy or a share of its greatest spoils. Neither the young reformers nor the oligarchs were popular with the majority of the Russian people, yet none of them particularly cared. They were not involved in popularity contests, they were arguing over power and riches. Sometimes they might do things that were good for the Russian economy, yet they were mainly interested in achieving their own agendas than serving the national interests of Russia. [9]

The weakness of the Russian economy further weakened the position of the Russian government at the start of the Yeltsin era. These were political as well as economic weaknesses that still existed when Yeltsin left office. Yeltsin's first term was undermined by political disputes with the Russian Supreme Soviet, which Yeltsin eventually closed down and replaced with a new parliament, the Duma. Yeltsin had to maintain his political position whilst attempting to prevent the Communists and nationalists making sufficient electoral gains to restrict his political room to manoeuvre. Yeltsin was able to maintain his hold on power, despite a strong challenge from the Communists after his re-election in 1996. Yeltsin's second term in office highlighted his inability to find a Prime Minister that was politically reliable, could manage, or even reduce the weakness of the Russian economy and

who did not want to assume the presidency as Yeltsin's replacement before Yeltsin was due to leave office in June 2000. Yeltsin's second term witnessed his problems with ill health worsen, which in turn meant that the Russian economy as well as the Russian government was not as effectively managed as they needed to be. When Yeltsin appointed the virtually unheard of Vladimir Putin as Prime Minister he believed that he had found a man that could fix the Russian economy and solve its political problems. Perhaps more importantly for Yeltsin and his family, Putin was unwilling to prosecute either him or his relatives for their links to the corruption and inefficiency of the Yeltsin era. ^[10]

The Russian economy did show signs of revival towards the end of Yeltsin's first presidential term, yet in many respects such a revival was more apparent than real. The vast majority of Russians were economically worse off than they had been before the collapse of the Soviet Union. Declining inflation and unemployment rates did not benefit most of them, especially those that lost their jobs, their savings, and all hope with the shock therapy of 1992 which resulted in inflation rates of around 2,000%. The new Russian economy seemed to benefit former Communist party officials; bureaucrats, factory, and state farm managers that managed to gain control of former state owned enterprises. The other main beneficiaries were the handful of entrepreneurs, subsequently known as the oligarchs that had become very wealthy through their links with Yeltsin. The Russian economy for the first time also had millions of shareholders eager to show their capitalist credentials. The Russian government did not however, share in the beginning of the Russian economy during the middle of the 1990s, the

strength and capabilities of the Yeltsin government to deal with economic problems was undermined by falling revenues. Government revenues had been reduced through the economic contraction of the early 1990s, higher spending on social security, lower global prices for Russian oil exports, plus extensive tax evasion. Not that anybody had to deliberately evade paying their taxes given the massive size of the tax arrears owed to the Russian government. The breakdown of the Soviet Union led to other problems such as lower exports to the other former Soviet republics and the inability of countries such as the Ukraine to pay for Russian gas and oil. ^[11]

The table below that shows the annual changes in Russia's Gross Domestic Product (GDP) figures between 1992 to 1999 amply demonstrates the disastrous state of the Russian economy throughout much of the Yeltsin era.

1992	1993	1994	1995	1996	1997	1998	1999
-14.5	-8.7	-12.5	-4.1	-3.4	0.9	-4.9	3.5

[12]

Stock market crash and Government weakness

The perilous financial position of the Yeltsin government itself proved to undermine the revival of the Russian economy as it directly contributed to the collapse of the Russian stock market in 1998. The crash of 1998 ruined millions of small-scale shareholders in Russia and reduced the scale of

foreign investment in the Russian economy. Russian investors were in effect made to suffer due to the ineptness of the Russian government in raising enough taxes to run the country and avoid bankruptcy. ^[13] Under Yeltsin the Russian State had lost out in terms of revenue and economic independence to the oligarchs, profits that should have lined the coffers of the Kremlin lined the pockets of Boris Berezovsky, Vladimir Potanin, and the other oligarchs. All of these factors combined to make the insolvency of the Russian State as principle problem of the Russian economy. Restoring the solvency of the government would increase its scope to solve the other principle problems of the Russian economy, as well as restore the political authority of the state. ^[14] When Vladimir Putin assumed power his government was faced not only with the task of restoring the solvency of the Russian state, he also had to restore the faith of Russians and foreigners that the government would not default on its loans. The crash of August 1998 had led to the Yeltsin government defaulting on \$40 billion worth of foreign loans. The crisis in confidence also saw the rouble decline to a third of its pre-crash value. ^[15] The Russian economy was not helped by international bodies such as the International Monetary Fund (IMF) or foreign governments most notably the United States by the amounts of capital as the Russian government would have liked. ^[16]

As Prime Minister Vladimir Putin had already shown his commitment to restoring the solvency and the power of the Russian State. Putin's strength of character plus his determination to succeed contributed to Yeltsin's decision to resign and maximise Putin's chances of retaining the presidency after the 2000 presidential election. Putin was elected president in 2000 and <https://assignbuster.com/russias-economy-during-yeltsin-era/>

claimed the credit for Russia's improving economy as well as apparent victory in the war against Chechen separatists. Putin put himself forward as the man capable of curing Russia's profound economic, social, and political problems. If confidence alone was the sole key to solving the principle problems of the Russian economy at the end of the Yeltsin era, then Russia should have been a prosperous state the day Putin entered the Kremlin. ^[17]

Principle Problems of the Russian Economy

The first principle problem facing the Russian economy at the end of the Yeltsin era was the incomplete nature of the transition to a capitalist market economy. The support of Boris Yeltsin for the measures needed for a full transition to a market economy was not consistent throughout his time in office. The economic reforms introduced in 1992 hit the Russian economy harder than the similar reforms introduced in former Communist states such as Poland and Hungary. Russia had a larger economy, more state enterprises and factories plus a much longer period under communist control than any of the former communist states Central and Eastern Europe had. The Yeltsin government received plenty of advice as to whether to introduce economic liberalisation all at once or gradually, although at that point there was no hard evidence as to which approach would be the most successful in the long run. In the short run economic contraction was expected before the Russian economy would show signs of improvement and growth. ^[18] However, the period of economic contraction was longer than many experts had predicted, although the sheer scale of the problems facing the Russian economy throughout the Yeltsin era were enormous. A healthy Boris Yeltsin, despite

his lack of knowledge concerning capitalist economics, might have given the government more urgency in tackling those economic problems it could.

However, during his second term as president Yeltsin suffered from the affects of heavy drinking and a severe heart condition. Given the prominence of presidential power in the Russian political system having an incapacitated president was detrimental to the tackling of Russia's economic problems. Not only was Yeltsin frequently ill he would intervene in the government at some inopportune moments. Yeltsin had a tendency to appoint Prime Ministers and cabinets on a whim. If a Prime Minister proved incapable of tackling the country's many social, economic, and political problems they would be removed. Paradoxically if a Prime Minister was too successful in resolving those problems or appeared to be more popular than Yeltsin they were also removed from office. ^[19]

A principle problem facing the Russian economy at the end of the Yeltsin era was that a proper banking system similar to those operating in more established capitalist economies had not been fully developed to aid the Russian economy's transition in to a capitalist economy. There are various reasons why the lack of a fully developed banking system became a principle problem facing the Russian economy. The lack of such a properly developed and regulated system hindered and deterred foreign businesses from investing in the Russian economy, as potential investors could not be sure of where their money was going. The lack of foreign investment slowed down economic growth in the financial sector of the Russian economy. Growth in the financial sector was needed to compensate for the contractions in the industrial and agricultural sectors of the economy. ^[20] The lack of a properly

regulated banking system also aided the money laundering of illegal profits from the organised crime gangs that seemed to proliferate after the Soviet Union collapsed. Organised crime gangs had been able to take advantage of the Russian government's struggle to maintain full political and economic control of Russia. The unregulated nature of the Russian banking system did not help stem the flow of financial capital out of the Russian economy during the Yeltsin era. The Yeltsin government seemed unable or unwilling to take effective measures to stop the flow of capital that was so detrimental to the Russian economy. If the Russian government had been able to attract as much investment into the Russian economy as there was capital exported away from it then the economy would have achieved greater stability and growth. However, the IMF made economic aid and loans to the Russian government conditional upon the Russians on improving the Russian banking system to international standards of performance and regulation. The Russian government could in return claim that Russia's economic problems would have decreased if the Russians had received all the international aid and investments that had been promised in the early 1990s. Whilst aid was slow in coming forward the foreign debts owed by Russia from \$97 billion in 1992 to a burdensome \$152 billion by 1998. During the same period the amount of GDP the Russian government had to use to service its foreign debts doubled to 60%. That was money that the Russian government could have spent in more productive ways such as increasing spending on non-military research or tackling the social and economic problems that were reducing the performance of the Russian economy. ^[21]

A principle problem facing the Russian economy at the end of the Yeltsin era was organised crime. Organised crime gangs, as previously noted, took advantage of the lack of political and economic control in Russia. The way in which the transition to a capital economy in Russia had been attempted had benefited organised crime gangs. Organised crime had existed in the Soviet Union due to the people wanting consumer goods as well as drugs that were not available through state enterprises. Under the Soviet economy system all private economic activity had been illegal. Organised crime gangs find post-Communist Russia an easy place to operate with little fear of being caught, rival gangs were more of a threat to each other than the Russian police were to them. If the gangs could not bribe the police they could frequently outfight them. The financial dire straits of the Russian government meant that there were not enough police or customs officials to deter, let alone catch organised crime gangs and their members. Poorly or infrequently paid police and customs officials had little motivation in stopping criminals, including those that resisted the temptation to take bribes. [22]

Another principle problem facing the Russian economy at the end of the Yeltsin era was the informal economy in which employers paid in cash, whilst neither they or their workers paid taxes on their earnings or profits. However, the informal economy had in many respects helped to maintain the Soviet economy, despite its inefficiencies and stagnation. The economic reforms introduced at the start of the Yeltsin era offered chances and opportunities to organised crime gangs and individual entrepreneurs to make their fortunes. Previous experience of working in the informal economy did prove advantageous to many Russians wanting to make their fortunes or

faced with the more mundane task of surviving. ^[23] The Russians have a long tradition of people who know the right people within the bureaucracy being able to further their own position. Corruption, bribery, and the calling in of favours could make all the difference between success and failure during the Yeltsin era. The informal economy grew due to the greater economic freedom and the unregulated nature of the Russian economy once market liberalisation had occurred. For many Russians being part of the informal economy was the only way to make ends meet. The Russian government had drastically reduced the number of state owned enterprises, whilst cutting subsidies to the newly privatised enterprises. Private enterprises in Russia would frequently not pay their workers for months to try to stay in business as they found it very difficult to survive against foreign competitors. Not being paid for months or only been paid in kind prompted workers further into the informal economy. Due to the lack of money available to the Russian government public sector employees were not always paid either. Desperation forced many Russians into holding two or three jobs to make ends meet. Without the informal economy the social and economic problems facing Russia could have been worse. ^[24] When private and public sector workers were paid, the high inflation at the beginning of the Yeltsin era meant that most Russians had to find extra sources of income or face economic ruin. It is difficult to have an accurate idea of the informal economy within framework of the Russian economy in terms of its share of GDP and its actual size. Statistics from the Russian government were even in the 1990s domestically or internationally known for their accuracy. Given the lack of resources available to the Russian police, customs officials, and bureaucrats it is not surprising that few people were caught for their

<https://assignbuster.com/russias-economy-during-yeltsin-era/>

involvement within the informal economy or that Russian officials could be bribed to turn a blind eye. During the Yeltsin era, the Russian government estimated that 25% of Russia's GDP was generated by the informal economy. Other sources such as the IMF and the Russian press put the figure as high as 80%. [25]

The harsh economic realities of life in Yeltsin's Russia meant that corruption and unregulated economic activity increased dramatically. Organised crime gangs were able to gain from people's misery and desperation in terms of increased levels of drug taking and prostitution. The collapse of Soviet authority and the difficulty of Russia and its neighbours had in securing their mutual borders had given the organised crime gangs the opportunity to expand their activities as well as their profits. [26] These increases in gang activities lead to higher levels of crime, as people had to resort to desperate measures to feed drug habits and gangs fought each other. Although the outbreaks of gang warfare witnessed in cities such as St Petersburg can mainly be regarded as a law and order issue, such events did have an economic impact during the Yeltsin era. Economic hardship, drug taking, and prostitution have heavily contributed to declining life expectancy rates. Many of the people that should be the most economically active in Russia are either working informally and therefore not paying taxes or they have died prematurely. Drug taking and prostitution have increased the spread of AIDS so that Russia has one of the highest infection rates in the world. The demographic decline in Russia, if left unchecked could have major implications for the Russian economy as well as disastrous effects on its society. Organised crime may help many Russians survive from day to day,

yet it makes some gang members very wealthy whilst depriving the Russian government of much needed revenue and leaving the cost of sorting out serious law and order as well as health problems. Organised gangs were also able to take advantage of the Russian governments wars in Chechnya during the Yeltsin era by selling drugs and weapons to both Russian troops and Chechen rebel fighters. ^[27] Overall the effect on the population of the Russian Federation was an average annual decrease in the population of around 750, 000 people throughout the entire 1990s. ^[28]

At the end of the Yeltsin era another principle problem facing the Russian economy was the uncompetitiveness of many industries and businesses. Again the legacy of the economic system of the Soviet Union plays its part in the weaknesses of the Russian economy. The Soviet system had not produced goods that Russian consumers or potential foreign consumers had wanted. Instead the Soviet economic planners had determined production levels and the types of goods produced. Once state subsidies were removed all factories and enterprises and the Russian economy was open to unrestricted foreign imports. Russian enterprises were forced to close, drastically cut their workforces, or not pay their workers for long periods. Some businesses resorted to not paying their taxes as part of their efforts to stay operative. ^[29] One of the leading oligarchs, Mikhail Khodorkovsky estimated that upwards of a million Russian enterprises should have been declared bankrupt. In 1996 the Yeltsin government stated that around 35% of Russian factories and businesses were on the verge of bankruptcy. The Russian government estimated that 80% of Russian factories and businesses were in financial dire straits. ^[30] The instability of the rouble and a lack of

<https://assignbuster.com/russias-economy-during-yeltsin-era/>

foreign currencies and investment also made it difficult for Russian enterprises to remain competitive. De-valuations of the rouble would briefly aid competitiveness, yet did not offer a long-term solution. Lack of foreign investment and profits made it more difficult for Russian factories to replace obsolete equipment or the latest training for their workers. The standard of education in Russia tended to be high, although there was a lack of people trained in Information Technology and more advanced industrial procedures, especially outside of the military research establishment. ^[31] The Yeltsin government and the young reformers had hoped that large-scale foreign investment would revive even the most outdated enterprises in the Russian economy. Although, not all of the potential foreign investors were put off by the lack of market regulation, the less than welcoming reception received from officials, Russian businesses, and the Russian public deterred many investors from investing in Russia. ^[32]

The young reformers had hoped that their policies would only lead to a short-term contraction of the Russian economy, with a more competitive and modernised Russia emerging from shock therapy. They and Yeltsin were caught by surprise when the affect of shock therapy lasted throughout the Yeltsin era. A sharp contraction in the production levels of Russian heavy industries was expected and indeed occurred. However, the biggest falls in production witnessed during the Yeltsin era was in the production of consumer goods rather than in the more traditional heavy industries. Whilst production in those heavy industries of coal, steel, oil and gas declined by 45% during the 1990s that was not as bad as the decline in production of consumer goods. The move to a capitalist market economy had been

anticipated to provide stimulation for increases in the production of Russian made consumer goods such as colour television sets, personal computers, and video recorders. Instead production of these consumer items declined dramatically, by 80% for television sets, 60% for personal computers, and 99% for video recorders. A section of the Russian economy that the government had believed would promote economic growth and provide jobs for those that lost their jobs in other sectors of the economy ceased to exist to any meaningful extent. There are two fairly straightforward explanations for the slump in the production of consumer goods. Those Russians that could afford television sets, personal computers, and video recorders brought more reliable and fashionable imported foreign brands. Through the liberalisation of the Russian economy and the efforts of the informal economy such goods became more widely available if not affordable throughout the Yeltsin era. For the poorest sections of Russian society that had their savings wiped out by inflation and their prospects diminished by unemployment or underemployment throughout the Yeltsin era there were little prospects of them buying the essentials to live let alone Russian or non-Russian consumer goods. The poor could not even afford the low quality and cheaper Russian made goods. [33]

A principle problem of the Russian economy closely related to its uncompetitiveness was the increasing shortages of workers, skilled ones in particular. At the start of the Yeltsin era the severe contraction of the Russian economy meant that unemployment had increased. It was not only capital that left the Russian economy once the country moved to a market economic system. Some of the brightest and most capable people working in

the Russian economy left the country for better pay and prospects abroad. Of course, not everybody was able to take the opportunity to earn his or her future in exile. In some respects the most harm done to the Russian economy was by the calibre of academics and technicians that left the country. The Yeltsin government could not do as much to halt the brain drain as it had to cut spending on higher education, health services and most notably on defence projects and research. Cuts in defence spending could be justified, as a war with the United States and its NATO allies seemed impossible. The shortage of skilled workers was worsened by the reduction in life expectancy, especially amongst men. The effects of lower life expectancy were mult