Lost Opportunity: Why Economic Reforms in Russia Have Not Worked

By Marshall I. Goldman

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Review by Andrew B. Loewenstein

Like a long-slumbering woolly mammoth awakening suddenly to discover he is no longer in the Ice Age, and then shedding his hair in order to withstand the new warmer climate, so too must Russia shed its centralized economy in order to survive the sweltering heat of post Cold War global reality. It is in this sense of awakening that Russia has taken its first lumbering steps towards economic reform. Beginning with Gorbachev's often contradictory and all too limited initiatives, then lurching to the trauma of Yegor Gaidar's shock therapy, the success of economic reform in Russia has been largely disappointing. Rather than boosting Russia's prosperity, misplaced and ill-conceived reforms have been responsible, to a significant degree, for the conservative backlash of the 1993 elections which sent to Parliament a strong coalition of Communists and extreme nationalists.

Political radicalism is the spawn of economic instability. Therein lies the paradox; democratization requires either concurrent or prior economic reform, yet the very process of economic reform itself brings about the sort of instability inimical to democratic consolidation. Without a stable civil society upon which democratization can be based, such attempts may be doomed to failure. For civil society to be sustained, economic stability is essential.

In Russia, however, attempts to move toward a market economy have produced widespread economic dislocation. This in turn has created an atmosphere ripe for discontent. In the absence of economic stability, the appeal of further reform, whether political or economic, becomes greatly diminished, and a nostalgia for the more orderly days of authoritarianism sets in.

Economic insecurity and its accompanying social and political instability have ramifications reaching far beyond internal Russian affairs. Russian stability has, and will continue to have, a direct impact on external issues of paramount importance, including the direction of NATO and the further orientation of Central Europe. If long-term stability in post-Cold War Europe is to be achieved, Russia must make a successful transition to a market economy. To date, that transition has been halting at best.

Writing after the heady days immediately following the Cold War, when the prospects for a smooth Russian transition to the market gleamed brightly, Marshall Goldman analyses the attempts to reform the Russian economy with the knowing pessimism of hindsight. Recognizing initial hopes as unrealistic, Goldman argues that reforming the post-Soviet economy necessarily will be a long and drawn-out process. However, that reality did not necessitate the subjection of the Russian people to the widespread trauma symptomatic of the reform policies that have been pursued. In fact, the path of Russian economic reform is littered with "lost opportunities" which, if taken, could have made the journey far less jarring.

While Goldman finds Gorbachev admirable for recognizing the need to revitalize the Soviet economy, and willing at least to consider novel approaches, he nonetheless holds that the first ruts in the road of economic reform were unwittingly dug by Gorbachev. Irreconcilably wed to the communist system, Gorbachev lacked the will to see his limited initiatives implemented, thereby stymieing any real chance for comprehensive success. Unwilling to accept a radical departure from the centralized economy, Gorbachev limited his reforms to tinkering within the existing Communist framework. Moving beyond the centralized economy and into the unchartered regions of the market was a daunting prospect, the implications of which Gorbachev feared could send the entire system crashing down. Though willing to commission reform proposals—eleven or twelve by some accounts—Gorbachev ultimately rejected every one:

> Like the bridegroom who can never quite bring himself to show up at his own wedding, Gorbachev could never bring himself to accept the changes such proposals would inevitably set in motion. Potentially, much more could have been done, but because of his reluctance to implement the plans, little was accomplished.

Goldman's central criticism of the Russian reform effort is the recurring inability of reformers to grasp that improving the lives of the people must be a fundamental goal of economic reforms. For Goldman, this goal is necessarily equated with increasing the supply of consumer goods long relegated to minimal importance by the planners of the Soviet command economy.

As Goldman aptly points out, half-hearted and contradictory reforms, rather than revitalizing, succeeded only in making a bad situation worse. Gorbachev's attempts in 1987 to stimulate the private sector is telling. Rather than granting the right to open businesses to the entire populace, Gorbachev restricted that right only to pensioners and students. Although the restriction was lifted two years later, the unintended effects of severely limiting competition continues to stymie the growth of the private sector. Restricting entry virtually insured that those brave enough to venture into the market would be richly rewarded. New entrepreneurs, able to capitalize on society's long neglected consumer wants, quickly became natural targets for an insurgent

Mafia. In short order, the emerging private sector became dominated by organized crime. Desiring to keep prices high by limiting competition, the Mafia has, and still continues to, keep out potential entrants through intimidation.

There has been much heated debate over the optimal pace of economic reform. At the crux is whether reform should have proceeded at a gradual pace, or if shock therapy was the appropriate tact. Goldman analyses the question from a historical perspective, comparing the Russian situation with the market transitions of Poland, Hungary, and China. Goldman concludes that a gradual process along the lines of the Hungarian or Chinese models, if undertaken intelligently, was still a viable option in 1985 when Gorbachev first began his reform initiatives. The luxury of gradualism was afforded by the fact that though the economy was stagnating, it had not yet reached the crisis situation that was to face Yeltsin and Gaidar.

However, by the time of the emergence of the Russian Federation, the situation was rapidly deteriorating, and "almost as much money was printed to finance the budget in 1991 as between 1947 and 1990." The luxury of taking a gradual approach to reform disappeared, and consequently Yeltsin had to move quickly. As in Poland, shock therapy seemed to be the answer. However, Yeltsin, like Gorbachev before him, by retaining a high degree of regulatory control over new businesses, failed to unleash the full force of the private sector. Goldman reflects that Yeltsin should have eliminated almost all restrictions inhibiting the formation of private enterprises, thereby vastly increasing competition.

While Goldman's points are well taken, his analysis generally does not account for the political climate in which economic reforms took place. While it is true that reform from the beginning should have been more encompassing, especially with regard to lifting restrictions on entry into the market, Goldman generally does not address the political viability of such sweeping reforms. It is not enough merely to say what should have been done, one must understand why given the realities of the day, a more comprehensive package was not, or perhaps could not be adopted.

Goldman's analysis of the reform effort is peppered with suggestions for what should have been done. He argues persuasively that fostering the growth of new businesses was wrongly de-emphasized in favor of privatizing state-run enterprises. For Goldman, this approach is detrimental on two counts. First, Goldman posits that the economy must be responsive to consumer desires. This can only be accomplished if widespread competition in the private sector allows prices to remain low. By failing to provide adequate opportunities for easy market entrance this was not achieved, and consumer goods became caught in an inflationary spiral.

Second, privatization of state-run enterprises will have only a limited effect on revitalizing the economy. Inefficient dinosaurs designed for the command economy, state-run enterprises are ill suited for the rigors of the market. In most cases, privatization is unable to convert these temples of inefficiency into competitive entities. Goldman, therefore, prefers concentrating on stimulating new growth in the private sector. However, this strategy, while appropriate, does not address the original question of state enterprise inefficiency, and Goldman offers no solutions to this problem, though over the long term it may be the most serious.

Lost Opportunity sets out to analyze how and why Russian economic reforms went array. Here Goldman argues his case with clarity and persuasion. However, he would have done well to go beyond merely discussing what should have been done by addressing the more pressing issue of what should happen now.