The End of Three Ideological Eras: What Is Next for the Russian Economy?

JAMES MILLAR

> [T]he ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately. . . . But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.
>
> —John Maynard Keynes

The Russian economy today is the product of three powerful ideas, all of which are now defunct: the Marxist system, the concept of the self-regulating market, and transition economics. The question for the next ten years is whether a new ideology or pure pragmatism will guide Russia's economic development. This is not to suggest some silly idea about the end of ideology or of history, but to recognize that these three ideologies are spent forces and that an alternative or new idea is absent for the present.

The Marxist Idea

The labor theory of value is central to the Marxist conception of economy in only one sense: it is a truism that all social value is created by human effort, physical and mental. Given that the desirable products of human effort are scarce relative to demand for them, the system by which goods and services are distributed is critical in determining who gets what and who does without or with less. Marx understood that property relations and markets under capitalism mobilized inputs and determined distribution among classes of society. Marx was an optimist with

James Millar is a professor of economics and international affairs at the George Washington University. He is the former director of the Institute for European, Russian, and Eurasian Studies and currently editor of the journal *Problems of Post-Communism*.

respect to the future of capitalist production, which he forecast would relentlessly increase output per capita thanks to technological change and competition among capitalist producers for profits. He accepted the historical necessity of capitalism and capitalists because they were so efficient at increasing economic capacity, but he condemned them for the inequitable distribution of the fruits of human labor that made this possible. The creation of a socialist state conformable with the Marxist idea would be one in which equity, not efficiency, would be achieved. Once scarcity was conquered, capitalism and capitalists alike would be otiose and would be relegated sooner or later to the dustbin of history. With them would go private ownership of the means of production, markets, money, prices, wages, and interest.

The Soviet socialist economy, after several starts and stops, was indeed constructed in essential conformity with the Marxist system. Private property in the means of production, including land, was nationalized fully with the termination of the New Economic Policy. Detailed administrative planning replaced the market for the organization of production, allocation of investment expenditures, and the ultimate distribution of GDP. The exceptions were forced on the regime either by the premature state of economic development or for political reasons. Resistance to collectivization and the presence of famine led to the tolerance of private plot agriculture and to open markets for products from these plots. With the exception of direct allocation during World War II, labor was allocated in large degree by money wages, but public goods were preferred and dominated education, medical care, transportation, and housing. Because money wages remained, consumer goods and services were sold on state markets at prices set by the state and on true price-making markets for privately produced goods. Thus, the Soviet socialist economy in the postwar years was a mixed economy but strongly reflected the antipathy of Marxism for private property, markets, money, wages, and interest.

There is no need here to recite the reasons for the downfall of the Soviet command-administered economy. My concern is with three tenets of the Marxist idea that the Soviet economic experiment has shown to be erroneous. First, Marx's optimistic forecast that capitalism would conquer scarcity has clearly proved wrong, and maybe unfortunately so. The worldwide revolution has not occurred and is unlikely to do so, and scarcity relations remain within and among nations. Not only were Soviet planners obliged to continue to operate with a wage system, money, and markets in the household sector, but they also found themselves tolerating inequities in distribution of income and consumption for political as well as economic reasons.

Second, Marx was pre-Darwinian in his conception of the process of human and economic development. His was a model of economic progress moving from the lower to the higher, from inequity to equality, and from exploitation to utopia. It is clear today that there is nothing inevitable about economic development. Also, there is no obvious terminal point of human history and no assurance of unambiguous progress, economic or otherwise. Soviet leaders, at least through Gorbachev, really believed that socialism was destined to emerge triumphant in the end. Their isolation from the world reinforced this illusion. It would appear, however, that history has no favorites.

Third, Marx seems to have misread one important aspect of the history of civilization. The earliest traces of civilized life reveal two things: Markets began as external trade very early in human history. The uneven geographical distribution of resources and cultural differences ensured that societies located at a distance from one another would mutually enjoy comparative advantages in trade. Trade, therefore, was not a zero-sum game, but under competitive or noncoercive conditions benefited both traders. Second, markets migrated into the domestic economy, extending first to commodity trading, then to labor services, and finally to land because markets offered the most efficient way to organize allocation of these factors and products. Money and price-making markets offered enormous advantages in the way of the flexibility of multilateral trade and the ability to spread payments over time.

The collapse of the Soviet planned economy ended the most extensive attempt to implement Marxism ever, and it is unlikely that another attempt will ever be made to create an economy of any scale that rejects private property, markets, money, financial instruments, prices, money wages, profits, and interest. Thus, the Marxist conception of an economy that would be the negation of capitalism is a dead letter today. Which is not to say that the Marxist idea has no continuing appeal. Paul Sweezy once claimed, in a graduate seminar at Cornell University in 1959, that the specific trappings of Marxism were common elements of nineteenth-century economic thought, but that he personally believed in "the spirit of Marxism." I take it that he meant by that an emphasis on equity in the distribution of economic wealth and income and the optimism underpinning dialectical materialism. Most non-Marxist economists also share the unproven and subjective assumption that a more equitable society is a better society. Marx's ideas can be expected to retain their allure for oppressed peoples, for his doctrines include justification for violent revolution to overthrow oppressors and promise a better world in the end.

The Idea of a Self-Regulating Economy

The concept of a self-regulating economy, where intervention by government or governmental agencies is unnecessary and actually economically harmful, has a long history in Anglo-American economic thought. Adam Smith's reference in 1776 to an "invisible hand" guiding the efficient allocation of resources is one of the earliest. The conception of a perfectly competitive market economy has been criticized as theoretically naïve if taken literally, and attempts have been made throughout the twentieth century to replace it with other more realistic ideas, such as monopolistic competition or the theory of countervailing power. The American Institutionalist movement of the 1920s through the 1950s presented a strong challenge to the notion that the market could be expected to regulate itself and achieve satisfactory economic performance. Keynes's General Theory was also proposed as a criticism of the notion and as a possible remedy for its deficiencies at the macrolevel.

The staying power of the idea of a perfectly competitive economy historically is quite impressive, for it survived these critics and alternatives. At the end of the 1950s the concept, now called "microeconomics," began a comeback that, along with strict monetary policy, eventually became the guiding ideology of conservative economists in the United States and Europe, and also of the IMF in its dealings with countries confronting economic crises. Throughout the second half of the twentieth century the economics profession became increasingly conservative, perhaps simply in reaction to the challenge of socialism Soviet style, which appeared to be making substantial progress. Soviet GDP was growing relatively rapidly, and Soviet-type economics spread to Eastern Europe and China and was admired in Africa and parts of Latin America. As substantiation, I offer the triumphal reaction of Western economists and politicians to the collapse of Soviet socialism in the USSR and elsewhere.

"The American version of capitalism has been tarnished and can no longer serve as the model for developing countries."

Several factors have qualified the sense of triumph since 1991. The difficulties posed by the transition from command-administered economy to market economy have clearly been an important qualification, the specifics of which I will take up in the next section. The collapse of the speculative bubble in 2001, known as the "new economy bubble," is another. The loosening of regulation of markets, particularly financial markets, and a heady pro-business popular attitude created an atmosphere of "irrational exuberance" and showed once again that, although the market is to a degree self-regulating, it will not produce satisfactory results on a consistent basis without outside regulation and monitoring. In the course of praising market forces, market-boosting economists neglected the importance of economic, legal, and social institutions that are required to ensure satisfactory performance of the market economy. Confidence in the durability of market transactions requires broad acceptance of ethical business mores, widespread adherence to contracts that bind into the future, and a general commitment to business strategies that emphasize the long run. The perfectly competitive model assumes the existence of these critical institutions and, as we see in advice given to transition economics, took them for granted.

There is a great deal of truth in the laissez faire model of capitalism. Where markets work satisfactorily, it is best for government regulators to stay out. Where individual decision making is guided by self-interest but constrained by effective competition, individual liberty is fostered along with the economy. However, during the cold war, and especially during the triumphalism occasioned by the West's having won it, belief in the capitalist system became an ideology rather than a theory. What is the difference between ideology and theory? An ideology is true for all time. There are no exceptions. A theory is provisionally true until proven otherwise. Ideologies blind their adherents to the inconvenient facts. Theories must be tested by reality. The truth of laissez faire capitalism is a contingent truth. The failure of Soviet socialism and the negative implications of that failure for applied Marxism eliminate a competing idea for organizing society and the economy, but the failure does not in and of itself validate capitalist markets.

The international financial crises of 1997 and 1998 and the New Economy bubble that burst in 2001–02 have raised serious questions once again about faith in the self-regulating market, especially in the United States, where the idea has been most prevalent. Even the Republican Party has had to deal legislatively with market failures and with unacceptable and even illegal instances of corporate governance. The famous movie phrase "Greed is good!" is unlikely to be repeated in the near future unless accompanied with the additional words "if constrained by transparency and vigorous competition." The American version of capitalism has been tarnished and can no longer serve as *the* model for developing economics.

The Transition Idea

When the Soviet empire began to crumble, a whole new economics specialty sprang up to deal with the desire of most of the former Soviet satellite countries and even former republics of the USSR to develop market economies. This new specialty became known as "transition economics." Western economic development specialists in academia and in the main international financial institutions, such as the IMF, the U.S. Treasury, and OECD, had developed a strategy to deal with the growth crises and inflation that characterized Latin America in the 1980s. It was labeled "neoliberalism," and it was derived from theories put forward by adherents of strong versions of the idea of the self-regulating market, notably the Austrian school (Hayek), monetarists (Friedman), and public choice advocates (Buchanan), among other conservative movements in the economics profession. John Williamson described the package of policies that was urged on the Latin American countries as "the Washington consensus." The consensus included ten measures:

> (1) Fiscal discipline should be imposed to eliminate the fiscal deficit, (2) priorities in state expenditures should be changed to eliminate subsidies and to enhance education and health expenditures, (3) a tax reform should be implemented, with increased rates if unavoidable . . . , (4) interest rates should be market-determined and positive, (5) the exchange rate should be market-determined, (6) trade should be liberalized and outward oriented . . . , (7) direct investment should suffer no restrictions, (8) state-owned enterprises should be privatized, (9) economic activities should be deregulated, and (10) property rights should be made more secure.[1]

The first five conditions describe orthodox fiscal and monetary policies designed to reduce inflationary pressures and stabilize the economy. The second five reflect the belief that economic growth would resume and efficiency increase by reducing government intervention in the economy and relying instead on the self-regulating market.

Although there were some successful applications of the Washington consensus initially, especially in ending hyperinflation in Latin America, in the long run the Washington consensus has failed to promote sustained growth and stability. The states that sought earnestly to follow these neoliberal policies have suffered high unemployment, increased poverty, politically unacceptable increases in economic inequality, and in the end, financial crises. Today the Washington consensus is in tatters and the IMF has lost much of its credibility. Argentina is a good example, for it was at one time the poster child of the IMF's policies.

Taken individually, only one or two of the ten propositions of the Washington consensus is likely to cause disagreement among academic or practicing economists. The first four are unexceptionable components of any macroeconomic stabilization program. There is some debate today about propositions 5 and 6, especially if either is applied inflexibly. Experience has shown also that foreign portfolio investment is volatile and risky. Propositions 8 and 9 are, however, matters of degree, and successful market economies reveal wide variations in state enterprise and state regulation. The main reasons for the ultimate failure of policies based on the Washington consensus in Latin America were, first, the lack of pragmatism in carrying them out and, second, the belief that the policies could be implemented simultaneously and quickly.

If Russia were embarking on the transition from planning to markets today instead of in 1991, things would be very different. Shock therapy was based on the Washington consensus, but in this case the changes required were much more radical than in Latin America. There was no experience with macroeconomic policies, no central bank to manage interest rates; there were widespread subsidies of enterprises as well as consumer goods; everything was state owned, property rights were inchoate at best, and prices and wages were fixed and wildly out of kilter with actual economic scarcities. There would be very few champions of shock therapy today even in the IMF and U.S. Treasury. Besides, the reputation of the IMF has been tarnished by failure and the taint of ideological rigidity.

At the time, however, Russia's Western advisers, including the IMF, underestimated what was involved in converting the command-administered economy into a working market economy. It is as though they believed that the market economy is the default version of an economy. All that was required was to destroy the planning instrumentalities, and markets would spring up like mushrooms after the rain. They also completely misunderstood the preferences of the Russian population. What the population wanted was to have its cake and eat it, too. That is, they wanted the consumer prosperity enjoyed by market economies, and the security of jobs, income, and public goods they had had under the Soviet economic bureaucracy. The economic reformers in Russia failed to explain or to sell the market system to the population. They also failed to be candid about the costs involved in the transition. Finally, Western advisers underestimated the complexities and difficulties involved in creation of the economic and legal institutions that are necessary to undergird markets and ensure satisfactory economic outcomes. Russian economists and politicians were understandably more naïve about such needs, and they also believed that a market economy could be established in nine months, or maybe five hundred days. The mindset of these Russian and Western economists is hard to fathom today.

Shock therapy—that is, a very rapid transition, in this case from central planning to market institutions and laissez faire policies—as implemented in Russia was based on a mistaken economic assumption and an undemocratic impulse. The latter is easy to explain. Policymakers in Russia and their Western advisers knew that shock therapy would be economically painful for many citizens. The liberalization of prices was certain to depreciate private savings and income because prices in the aggregate would rise sharply. Çonsequently, they chose to act swiftly before popular resistance to reform stopped it. For the same reason, no advance explanation for price liberalization was given. The reformers believed that they knew best what was good for the citizenry. Democratic persuasion was not even considered.

The mistaken assumption derived from the way economists represent and conceive of economic activity: the idea is that the economy may be viewed as a system of simultaneous equations that solve for all prices and quantities at once. This is an important insight (but not literally true) into the way economies operate. Everything depends on everything else. It would seem to follow that all prices, wages, and other ratios should be allowed to change simultaneously. There is a further conceptual dilemma. Liberalization of prices before privatization of productive assets will not produce true scarcity price ratios. Privatization before liberalization has no way to value productive assets for sale purposes. The truth is that capitalism developed piecemeal and that reform in existing market economies is also almost always piecemeal.

Shock therapy proper ended by mid-1992. The inflationary jump that was expected could not be contained, and the hyperinflation that developed was worse than anything that preceded it. Subsequent reforms have been piecemeal, including privatization. Price liberalization was followed by several privatization schemes, each more unfair than the last, culminating in the "loans for shares" program that financed Yeltsin's election in 1996 and sold public assets for a song. Paraphrasing Thorstein Veblen on nineteenth-century American economic development, Russian privatization involved turning public property over for private exploitation as rapidly as possible. And it was followed by asset stripping on an unprecedented scale. Meanwhile, a cardinal tenet of the Washington consensus, balancing the state budget, proved politically impossible. Deficit financing, which relied increasingly on the sale of short-term government bonds, many denominated in dollars, and IMF loans led to the 1998 financial crisis. At that point Russian policymakers stared into the abyss of sovereign bankruptcy. Thereafter they have followed more conservative macroeconomic policies and shunned the enabling services of the IMF. The transition, defined as rapid economic transformation, was over.

What Is Next for Russia?

For the next decade at least, the Marxist idea for organizing a social system, the idea of the self-regulating market, especially as represented by the United States, and the idea of the transition conceived as a rapid transformation of the economy, are all defunct. The last is unlikely to return, ever, as it was an idea devoted to a unique period in economic history. The Marxist idea is unlikely to influence Russian economic policy except in a watered-down version of the welfare state. Similarly, the self-regulating economy has lost its luster, and policymakers in Russia realize today that the problem is not a central government that is too strong, but one that is too weak. They recognize also that less central direction of the economy and more regulation are required. The European Union is more likely to influence Russian policy today.

So, what are the likely contours of Russian economic development in the next decade? In the absence of a ready-made ideology, Russian leaders are likely to be guided by pragmatism and/or by historical and cultural trends. First, as a carryover from the Soviet period and its commitment to Marxism, Russia will continue to attempt to provide a wide spectrum of social services, but the economy will not support generous systems. Second, as a consequence of the way privatization was carried out, the "commanding heights" of the economy, to use Lenin's phrase to describe heavy industry, financial services, insurance, defense industries, transportation, and the electricity grid will be jointly operated by private oligarchs and public officials. Most of these enterprises were only partially privatized. The state still has a stake in many, and it will be sure to regulate the others, and in this it has popular support. Third, public antipathy to market reform ensures that future reforms will be piecemeal and gradual. So far, Putin has involved the Duma in reform successfully. It is rather odd, in fact, that economic reform has in this sense become more democratic, while other democratic freedoms have been eroded.

Gradual economic reform, modeled more or less on the EU, is the best hope for successful economic development of the Russian economy. However, miracles should not be expected. The enormous decline in GDP from 1990 to 1999 and the neglect of new investment over the same period dictate a long, slow restoration of economic capacity and output. Even with recovery, however, Russia can be expected to be troubled by its weak position in the global economy. Its future as a market economy may be closer to the performance and problems of Latin American economies than to European ones. We have yet to learn how to manage the global economy, and many surprises are certain to be in store for any forecast of a decade or so.

Russian development over the next decade will be influenced also by historical continuities that preceded the Bolshevik experiment and the transition back to market institutions. There are four important categories with implications for economic development. The first is the idea of Russia's historical uniqueness. Russian identity has always been torn between a desire to catch up with the West and the notion that Russia has a special mission in world history thanks in part to its geopolitical position between East and West. Slavophilism represents a pseudo ideology that periodically recurs in Russian history. The current phase under Putin is a rather pragmatic westernization, but westernizing phases have always been followed by reaction. A major economic setback could set off such a reaction.

A second historical continuity has been empire building. The breakup of the empire that the Bolsheviks inherited from the tsarist regime has created a strong sense of empire envy among the elite, and recent American troop movements into Central Asia have strengthened the envy and concern. Over the long run, Russia will dominate Ukraine and Belarus economically. It will continue to have a strong influence in Central Asia and in the Caucasus. These are expensive ambitions that Russia can ill afford at present.

The third continuity is the backwardness of Russian agriculture. The poor quality of resources in the sector ensures that it will remain backward for the foreseeable future. Land, capital, and especially labor resources are deficient in many respects. Historically, periodic attempts have been made to develop the sector. All have failed. Privatization failed before the Bolsheviks; collectivism failed, too; and privatization has thus far failed in the transition. Agriculture will remain a lagging sector for at least the next decade and, in all probability, much afterwards. The only hope is not individual farming, but large-scale farming linked to industry and processing enterprises on the model of *kontraktatsia* in the Soviet period. The investment required to become competitive with Western agriculture is staggering. Consequently, recovery and development of agricultural production will be spotty and focus on selected crops and animals.

Finally, Russia has a history of top-down, radical economic reform. Shock therapy is only the latest example since the time of Peter the Great. The worst-case scenario is one in which economic troubles lead to another radical reform. But this is an unlikely scenario because the last one has been so recent and so devastating for so many Russians. Revolution is unlikely, too, because the last one turned out so badly. A more likely course of events is for Putin and his successor to continue to modify Russia's economic institutions along the lines of the EU accession chapters. If they succeed, Russia may even join the EU. If they fail, they are likely to fail in Brezhnev or Oblomov fashion; that is, by settling for economic stagnation.

NOTE

1. Louiz Carlos Bresser Pereira, "Economic Reforms and Economic Growth: Efficiency and Politics in Latin America," in *Economic Reforms in New Democracies: A Social-Democratic Approach*, ed. Louiz Carlos Bresser Pereira, Jose Maria Maravall, and Adam Przeworski (New York: Cambridge University Press, 1993), 19.