

A RECONSIDERATION OF THE SHOCK THERAPY IN RUSSIA, 1991-1996

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ABSTRACT

A RECONSIDERATION OF THE SHOCK THERAPY IN RUSSIA, 1991-1996

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Following the collapse of the Soviet Union, Russia endured turbulent years of political and economic transformation. At the time, heated debates were focused on speed of reforms between the shock therapists and gradualists. Under President Yeltsin, Russia hastened its economic reforms through the Shock Therapy – radical structural adjustment policies that transformed Latin American countries few decades earlier and Poland just a couple years earlier. The general sentiment has been that the Shock Therapy in Russia between 1991 and 1996 failed. Based on the widely-propagated criteria of economic growth and democratic consolidation, I also conclude that the Shock Therapy in Russia failed within the given timeframe. I expand on Popov's (2000) arguments that the debate was misfocused on speed of reforms instead of strength of institutions. I reconsider the debate extrapolating on the medical metaphor to argue that the Shock Therapy failed due to misdiagnosis of the patient's illness, medicine overdose and the problems associated with the doctors. Simply put, firstly, I establish that the Soviet collapse was a deliberate political breakup - not an inevitable ideological or systemic implosion - that demanded immediate attention to politics, not economics; secondly, I criticize Russia's implementation of the neoliberal model of Shock Therapy in place of the original model; thirdly, I discuss the insufficiency and incompetence of the external help as well as the lack of internal political consensus and control that undermined the Russian transformation.

Key words: Shock Therapy, economic transition, neo-liberalism, Russia, Post-Soviet politics

ÖZ

RUSYA 1991-1996ŞOK TERAPİSİNİN YENİDEN DEĞERLENDİRİLMESİ

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Sovyetler Birliği'nin çöküşünün ardından, Rusya çalkantılı siyasi ve ekonomik dönüşüm yıllarıgeçirdi. Zamanında, hararetli tartışmalar “şok terapistler” ve “aşamalı geçişçiler” arasında oldu ve reformların hızı üzerinde odaklandı. Cumhurbaşkanı Yeltsin'in yönetiminde Rusya ekonomik reformları “şok terapi” ile hızlandırdı. Şok terapi – yani ekonomide uygulanan radikal yapısal uyum politikaları-bundan birkaç asır önce Latin Amerika ülkelerini ve sadece bir kaç yıl önce de Polonya'yı değiştirmişti. Genel görüş 1991 ve 1996 yılları arasında Rusya'da uygulanan şok terapi politikalarının başarısız olduğuyönündedir. Yaygın olarak kullanılan ekonomik büyüme ve demokrasinin yerleşmesikriterlerine dayanarak, bu çalışma da Rusya'da şok terapinin verilen süre içinde başarısız olduğu sonucuna varıyor. Bu tez,Popov'un (2000) argümanlarını genişleterek,tartışmanın yanlış bir şekilde kurumların dayanıklılığı yerine reformların hızına odaklandığınıiddia etmektedir. Bu teztartışmayı tıbbi metafor kullanarakyeniden gözden geçirmekte ve şok terapinin hastalığının yanlış tanısı, ilaç doz aşımı ve doktorlar ile ilgili sorunlar nedeniyle başarısız olduğunu iddia etmektedir. Basitçe söylemek gerekirse, öncelikle, Sovyet çöküşü kaçınılmaz bir ideolojik ya da sistemik infilak değil, kasıtlı bir siyasi parçalanmaydı ve acil ekonomik değil, acil siyasi çözüm gerektirmekteydi. İkinci olarak, bu tezRusya'daşok terapininorijinal modeli yerine neoliberal modelinin uygulanmasını eleştirmektedir. Üçüncü olarak, bu tez dış yardımın beceriksizliği veyetersizliğininıyanı sıra iç siyasi uzlaşma ve kontrol eksikliğininRusya'nın dönüşümünü baltaladığını tartışmaktadır.

Anahtar kelimeler: Şok Terapi, ekonomik geçiş, neo-liberalizm, Rusya, Sovyet sonrası siyaset

To Father and Mother, the heroes of my life

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Prologue

The common sentiment among academicians, public officials, and particularly ordinary citizens, is that the Shock Therapy – the radical economic reforms of early 1990s - in Russia has failed. The experience has been characterized disproportionately by “shock” than “therapy” (Gerber and Hout 1998). Certainly, proponents, such as Anders Aslund (2007a; 2007b), have been more optimistic maintaining that sufficient radical reforms created a market economy while lack of clear political agenda inhibited democratic consolidation. Opponents, such as Joseph Stiglitz (2002), have argued to the contrary that the Shock Therapy only created crony and mafia capitalism, while one achievement, the creation of democracy with meaningful freedoms, remained fragile at best. Meanwhile, Richard Sakwa (2008; 2004; 2013) considered it too early rule out democratization in Russia and considered rudiments of independent statehood, a market economy, and democratic institutions established.

To be sure, the question is contingent upon what was meant by “success.” If by success, the shock therapists meant preventing retrenchment of communism, then, the answer is “Yes, they have succeeded.” Also, if by success, they meant preventing the economy from complete collapse, then the answer is again “Yes, they have succeeded.” The measuring stick of success that I use, however, reflects the very objectives the shock therapists laid out to win the contract over the gradualists in the early 1990s. What the shock therapists meant by “success” was establishment of preconditions for economic growth and democratic consolidation (Aslund 2007; Stiglitz 2002; Sachs 2000; Friedman 2000). By their self-defined criteria, the shock therapists have most definitely failed.

The original Shock Therapy (henceforth Shock Therapy 1.0) referred to liberalization and financial stabilization (Sachs 2012). But later, it began embodying neo-liberalism (henceforth Shock Therapy 2.0): “the dismantling of all government intervention to establish a supposedly free-market” (par 81). Russia pursued Shock Therapy 2.0 with all of its three radical programs: i) Liberalization ii) Financial stabilization, and iii) Privatization. President Boris Yeltsin set six to eight month and Yegor Gaidar, the mastermind behind the Russian Shock Therapy, set three years as the timeframe for success of the economic policies (Suny 1993; Sakwa 2008; McFaul 2001).

In 1992 when the Shock Therapy was administered, the devastating socioeconomic costs became apparent immediately. Yeltsin was put under immense pressure from his unruly parliament and within 13 months was forced to replace Gaidar with a more conservative Viktor Chernomyrdin. The desperately awaited economic growth would ensue only 5 years later in 1997 to be quickly crushed by yet another crisis in 1998. Liberalization policies which were intended to break down monopolies and incentivize producers created hyperinflation that wiped out public savings, led to high unemployment and overall decline in outputs instead. Financial stabilization policies (e.g. raising interest rates, shrinking the money supply and exchange currency support) dampened investment and industrial output even further. Privatization enriched a small cohort known as the *Oligarchs*, while the number of people below poverty line skyrocketed as the government failed to pay welfare and pensions. Only seven years later, long past the timeframe, external factors such as devaluation and timely rise in oil prices would endow Russia with ten years of consecutive growth between 1999 and

2008 (Stiglitz 2002). Yet, the image of democracy and market economy was tarnished in the minds of ordinary citizens which explained, at least partially, the rise of an authoritarian regime under Vladimir Putin.

Proceeding with the medical metaphor, I argue that the Shock Therapy failed due to misdiagnosis of the patient's illness, medicine overdose and the problems associated with the doctors. Simply put, firstly, I establish that the Soviet collapse was a deliberate political breakup - not an inevitable ideological or systemic implosion - that demanded immediate attention to politics, not economics; secondly, I criticize Russia's implementation of the neoliberal model of Shock Therapy in place of the original model; thirdly, I underscore the insufficiency (concessional foreign aid or debt relief) and incompetence (misguided advice) of external help as well as the lack of internal political consensus (weak democratic disposition and high polarization) and control (command over other competing factions) that undermined reforms.

1. *The Patient*. Shock therapists emphasized the inevitability of the ideological and systemic collapse (Gaidar 2010; Aslund 2007a, 2007b; Boettke 2002), and its critics have adamantly insisted that the collapse of the Soviet Union was not inevitable and entirely preventable had the secessionist been kept at bay (Gorbachev 2000; Aron 2011). A scrutiny of Soviet records demonstrates that it was not a coincidence that the Soviet Union, under a politically and economically-centralized regime, endured for seven decades in spite of significant wars, political repressions, and economic inefficiencies. The resilience of an empire speaks ever louder that had it been ideological or systemic contradictions that led to its demise, the collapse should have occurred long before 1991.

A case study of the Soviet history reveals that Joseph Stalin consolidated power through his totalitarian regime and transformed the Soviet political and economic structures permanently. Only Mikhail Gorbachev would be able to bring substantial change but at the cost of unwittingly diffusing power. Boris Yeltsin would take advantage of precarious circumstances and the failed August coup in 1991 (the hard-liners against *Perestroika* attempted to overthrow soft-liners and Gorbachev) to reform power and dissolve the Soviet Union. Thus, much like the beginning of the Soviet Union in 1917 (the Bolsheviks overthrew the provisional government), its demise in 1991 was a result of deliberate political decision-making by insiders that demanded immediate attention to politics more than economics.

2. *The Medicine*. In essence, the Shock Therapy refers to three radical, contrationary structural adjustment policies: i) Liberalization ii) Financial stabilization, and iii) Privatization. The medicine was prescribed based on the lessons from Latin American and the Polish cases. The Shock Therapy, in its original conception, consisted of rapid liberalization and financial stabilization. The inclusion of rapid privatization into the agenda was a deviation from the original conception toward neo-liberalism (Sachs 2012). In Russia, the most controversial of reforms was privatization of large state-enterprises through the loans-for-share program that enriched the oligarchs and impoverished numerous ordinary citizens. This specific privatization scheme set in motion the severest capital flight that not only undermined Russia's economic growth but also its democratic consolidation by widening the inequality gap.

3. *The Doctors*. Nascent Russia's future was in the hands of four groups of reformers: independent foreign advisers, the IMF, the US Treasury Department, and

most importantly Yeltsin's administration (Aslund 2007a). They were, for the most part, committed to the Shock Therapy. Overall, external advisers played a little role with a possible exception of Andrei Shleifer, who advised Anatoly Chubais in the loans-for-shares program and later charged with fraud for illegal securities trade (Sachs 2012; Wedel 2001). The International Monetary Fund (IMF) proved incompetent and provided a number of faulty monetary and fiscal policy advices to Russia. The United States (US) clearly had experience, expertise and capacity to provide a Marshall Plan-like assistance but it chose to focus on ulterior objectives of disarming their arch-nemesis and preventing communist retrenchment (De Long and Eichengreen 1991; Rice 2000).

Despite the lackadaisical support from the West, had Yeltsin's administration been less polarized and more commanding over the country, reforms could have been far more successful. Again, this argument enforces the notion that Russia's most pressing needs were political reforms, not economic. Unless political reforms could establish political consensus and stability, economic reforms were doomed for failure. Essentially, the greatest testament to the fact that political reforms were more pressing than economic was the constitutional crisis in 1993 that not only obstructed economic reforms but almost destabilized the country like in 1917. Going back to the metaphor, the lesson was that without a clear consensus among doctors no successful surgery would be made.

Following the aforementioned three analyses, I compare and contrast Russia's reforms with other countries' reforms. The Latin American case demonstrated that Shock Therapy 1.0 is a functional tool in different political regimes: both in an autocracy or a democracy. It also elucidated how authoritarian regimes break apart

politically. The Chinese case demonstrated that gradualist reforms under socialism can generate economic growth, though not democracy. Most importantly, the Polish case demonstrated that Shock Therapy can indeed transform a socialist system into a market economy without hindering democratic consolidation.

In this thesis, I draw two conclusions depicting how the Shock Therapy brought more “Shock” than “Therapy.” First, the Shock Therapy as an economic reform policy did not create a precondition for promised economic growth within six months or three years or even five years that Sachs projected but a precondition for decline. Capital flights and corruption, high unemployment and wiping of savings, drops in outputs and income, were not compensated by sufficient economic growth. After seven years of prolonged recession, Russians would be hit by yet deep crisis in 1998, and only after timely devaluation and rise in oil prices would economy begin to recover. Hence, even solely from an economic perspective, it failed to deliver economic growth within the given timeframe.

Second, although the Shock Therapy and democracy, at best, share an indirect relationship, historical and empirical data reveals that the Shock Therapy did more harm than good to Russia’s democratic consolidation. The Shock Therapy undermined the democratic consolidation process by empowering the upper-class known as the *Oligarchs*, impoverishing the working-class, and neglecting the middle-class (Stiglitz 2002; Sakwa 2004; 2008). Such partial treatment has proven to damage democratic consolidation. Prolonged economic difficulties and widened inequality gap contributed to the brain drain, political apathy, and diminished influence of the harbingers of democracy (Rueschemeyer, Huber and Stephens 1992; Shkolnikov 1995).

The following is the breakdown of my thesis. In the first chapter I discuss the patient, a historical case study to argue that due to the political nature of the Soviet collapse, priority to Shock Therapy over political reforms was mistaken. I review the reforms pursued by three main figures - Stalin, Gorbachev, and Yeltsin - that shaped the country and argue that the country endured far greater challenges than 1991. In the second chapter I discuss the medicine, both the Shock Therapy 1.0 and Shock Therapy 2.0. I examine the objectives and effects of the Shock Therapy's three pillars and argue that Shock Therapy 2.0 undermined Russia's economic growth and democratic consolidation. In the third chapter, I discuss the doctors, the groups of reformers, and assess how successful they were in implementing the Shock Therapy. I argue that insufficient and incompetent external help as well as the lack of internal political consensus and control undermined Russia's transformation. In the final chapter, I compare and contrast the case of Russia with other countries that have undergone the same or different reforms in an attempt to discover the determinant of success and draw lessons.

Chapter 1: The Patient

Misdiagnosis of a Resilient Superpower's Demise

Introduction

In this chapter, I defend my position that the Soviet collapse was a deliberate political breakup by the insiders (Gorbachev 2000; Aron 2011) and not an inevitable implosion due to ideological or systemic contradictions (Gaidar 2010; Aslund 2007a, 2007b; Boettke 2002). The reason for the emphasis on the causation of the collapse is simple. Without a clear diagnosis, it is impossible to prescribe proper medication. Therefore, to properly assess the viability and applicability of the Shock Therapy, obtaining a proper understanding of the Soviet collapse is a prerequisite.

The Soviet Union was a resilient empire that had faced far greater calamities than that of the late 1980s, and thus I argue that misdiagnosis of a resilient superpower's demise led to improper remedies. The shock therapists misdiagnosed the illness to be of primarily economic in nature and thus prescribed economic medication that undermined Russia's transformation. A comparative study would confirm, again, that politics, not economics, would be decisive to attainment of economic growth and democratic consolidation.

A case study of the Soviet history reveals that Joseph Stalin consolidated power through his totalitarian regime and transformed the Soviet political and economic structures permanently. While most successors only tinkered with the system, it would be Mikhail Gorbachev who would be able to bring substantial change but at the cost of unwittingly diffusing power from the center. And, Boris Yeltsin would rise to take advantage of the failed August coup in 1991 and the precarious conditions in its immediate aftermath to reform power and dissolve the Soviet Union. Thus, much like

the beginning of the Soviet Union in 1917, its demise in 1991 was a result of deliberate political decision-making by insiders. This diagnosis, which differed from that of shock therapists, spoke loudly about the necessity to pay immediate attention to politics, even at the cost of economics.

George Kennan, an American diplomat and a political scientist, spoke presciently soon after the Second World War that “Soviet power like the capitalist world of its conception, bears within it seeds of its own decay.” He warned that if “... anything were ever to disrupt the unity and the efficacy of the party as a political instrument, Soviet Russia might be changed overnight from one of the strongest to one of the weakest and most pitiable of national societies” (Kennan 1947: 580 as cited in Sakwa 2008: 35). I searched the Soviet history for the turning points in “the unity and efficacy of the party,” and, I discovered that Stalin’s iron fist tightened the power that was gradually loosened under successive secretary generals. The decisive leakage of power, however, would result from Gorbachev’s political reforms. And it would be Yeltsin, who would decisively pull the plug. Yeltsin mistakenly assumed that dissolving of the Soviet Union and achieving independence of Russia would be sufficient on the political end to generate sufficient political consensus and control to carry out economic reforms. Unfortunately, he would be proven wrong by the constitutional crisis in 1993. He would later regret not having focused enough on political reforms earlier (Yeltsin 1994: 127).

The Resilience of a Superpower

In grand scheme of turbulent Soviet history, the challenges the country faced in late 1980s do not fit the description of an inevitable implosion as presented by many

shock therapists. For seven decades, the Soviet Union withstood despite numerous calamities: Russian Civil War (1917-20), a Polish-Soviet war (1919-1920), the Second World War (1939-45), and severe famines (1921-23, 1932-33, 1946-48, 1962-63, 1964-65)¹ (Gorbachev 2000; Gaidar 2010). Although statistics vary vastly, what is clear is that the Soviet Union withstood countless political and economic turbulences and if an inevitably implosion was destined, it would have occurred long before the 1980s. Rather, it gives cues that there were factors apart from ideological or systemic inefficiency and decay that contributed to the Soviet collapse.

First, the Soviet Union survived devastating wars.² The Soviet Union endured a civil war, a war with a neighbor, and a world war that challenged its political stability by every inch. The people had all the reasons to revolt against the government but they remained faithful. Boris Uralnis, the Soviet demographer, estimated 8 million deaths and Richard Pipes, an American historian, estimated 9 million deaths for the Russian Civil War between 1917 and 1920 (White 2003). Estimated 60,000 Soviet soldiers were killed and 80-157,000 taken captive during the brief Polish-Soviet War that was held between 1919 and 1920 (Rummel 1996: 55). For the Second World War that lasted between 1934 and 1945, David Glantz (2001:13), an American historian, estimated approximately 35 million Soviet military deaths. Soviet Union lost about 18 percent of the working population to war (Gatrell and Harrison 1993: 435). The industrial production became distorted with the ratio of military to civilian production having reached 328-47 in 1945 (Ibid: 440). Following the Second World War in 1945, the

¹ Many of these famines were entirely preventable and a result of collectivization. Large casualties were not the greatest concern for Stalin.

² For more detailed death toll estimations done by various scholars regarding the First World War, Second World War, and Stalin's political repressions, refer to Source List and Detailed Death Tolls for the Primary Megadeaths of the Twentieth Century (<http://necrometrics.com/20c5m.htm>)

Soviet grain harvest was only 61 percent of what was in 1936 (Ibid: 441). If the Soviet collapse was inevitable, it would have collapsed long before the 1980s.

Second, the Soviet Union's legitimacy was never undermined despite its political repression. National Security Advisor to US President Jimmy Carter, Zbigniew Brzezinski, (1993 as cited in White 2003) estimated that under Stalin 7 million peasants and 12 million political prisoners were murdered. Robert Conquest (1969 as cited in White 2003), an Anglo-American historian, similarly suggested that the overall death toll was 20 million; Norman Davies (1998, as cited in White 2003) estimated 50 million killed between 1924 and 53, excluding world war losses. If the Soviet collapse was inevitable, it would have collapsed long before 1980s.

Third, the Soviet Union survived several severe famines. Wars translated into decline in workforce and subsequent decline in production. Many famines claimed the lives of millions of people. Robert Conquest (1986: 53-55) estimated that a famine in 1921 claimed the lives of approximately 6 million people. R.W. Davies, a British economist, and S.G. Wheatcroft, an Australian historian, (2004: 401) estimated that a famine in 1932-33 claimed the lives of approximately 5.5 to 6.5 million people. Michael Ellman (2000: 622) estimated that a famine in 1947 claimed the lives of approximately 1 to 1.5 million people. In 1963, a bad year of harvest and depleted state grain reserves forced the Soviet government to use 372.2 tons of gold (more than one-third of its reserves) to buy food from abroad; in 1965, the Soviet government was again forced to spend another 335.3 tons of gold in exchange for food (Gaidar 2010: 95).³ If economic collapse was inevitable, the Soviet Union would have collapsed long before the 1980s.

³ Note that these were prior to termination of the Bretton Woods system that took countries off the gold standard in 1971-73

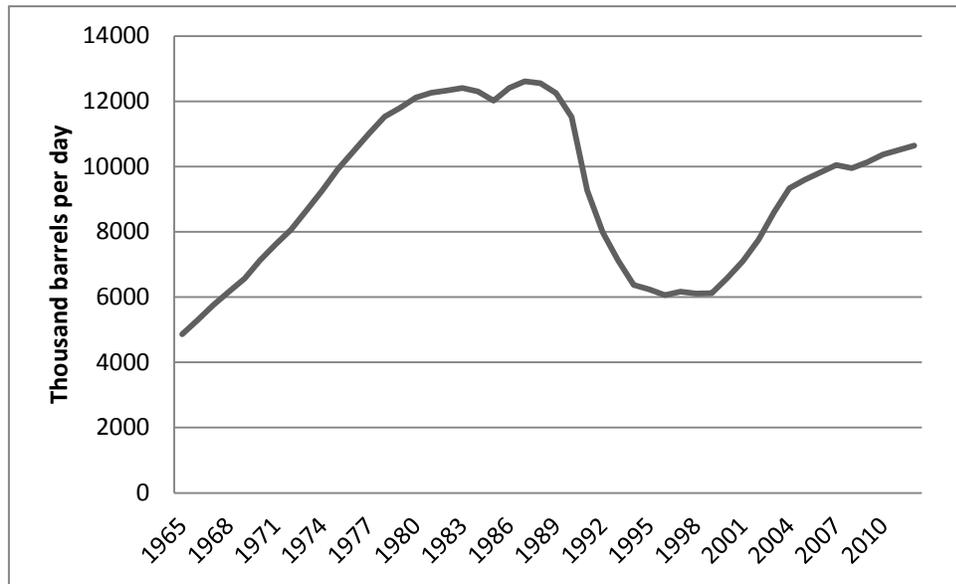
Fourth, despite its inefficient agricultural and industrial sectors, the Soviet Union always found ways to compensate for its deficiencies and continued to maintain a military parity with the US. The Soviet industrial sector - the hammer - grew increasingly obsolete domestically and uncompetitive internationally. For instance, machine building volume of production remained constant since 1986 until its collapse with the capitalist countries importing only 6 percent of machinery of which 62 percent were obsolete due to subpar quality (Gaidar 2010:122-123). In the first half of 1988 alone, as many as 194,000 goods were returned from abroad (Gaidar 2010: 124).

A greater concern, however, lay with the Soviet agricultural sector - the sickle - that remained inefficient and insufficient even for domestic consumption. George Kennan (1951: 355 as cited in Sakwa 2008: 308) referred to it as the “Achilles heel” of the Soviet economy. The irony was that a country with the largest arable land mass and the largest exporter of grain at the wake of the twentieth century digressed into the largest importer by the end of it (Gaidar 2010: 95). The average crop yields between 1975 and 1990 were a third of those in the US, and much of the produce was wasted as 80 percent of potatoes were spoiled during harvesting and then over half of the harvest rotted in storage (Sakwa 2008: 308). To compensate for the shortages, about 15 percent of world’s imported grain sustained the livelihood of the Soviets as every third ton of baked goods and cattle production were made from imported grain (Gaidar 2010: 95).

Nevertheless, the Soviet Union compensated for its inefficient economy through natural resource exports, internal imperialism (e.g. collectivization of 1930s), and external colonization (Eastern Europe after the Second World War) (Boettke 1993: 10). In the 1950s, by exploiting the Volga Oil Basins, Soviet oil exports began to climb in

significant amounts; through the 1960s, large oil deposit discovery in Western Siberia, enabled the state to continue expanding its production and exports (Gaidar 2010: 100). External factors also helped: oil shocks in 1973-74 resulting from the members of Organization of Arab Petroleum Exporting Countries (OAPEC) declaring an oil embargo and oil shock in 1979-81 resulting from the Iranian Revolution greatly benefited the Soviet trade balance. The hard currency from oil exports quickly resolved the endemic food shortages and also ensured a steady financial base for the arms race and the war in Afghanistan (Gaidar 2010: 102).

Figure 2 Oil Productions of the Soviet Union (1965-1990) and Russia (1991-2012)



Source: BP (2012)

Standards of living in the Soviet Union were lower than in most of Eastern Europe and the West. Shortages of food and acute poverty were endemic. Nonetheless, the Soviet Union had survived far greater calamities and coped without ever losing its grip on society and economy (Aron 2011). Budget deficit, which since the French Revolution became a portent of revolutions, equaled less than 2 percent of GDP in 1985

and grew to an entirely manageable 9 percent through 1989 (Ibid). In 1985, the Soviet Union was still the third largest economy in the world, though GDP per capita a meager 43rd (Sakwa 2004: 240). Even in 1989, its economy was the third largest in nominal terms and second largest by purchasing power parity in the world (CIA Factbook 1990).

Joseph Stalin's Consolidation of Power

The Bolshevik Revolution of 1917 triggered a new era marked by the Marxist-Leninist doctrine. Soon after the Bolshevik Revolution, the Russian Civil War (1918-1921) erupted between the Bolshevik Reds and the Menshevik Whites (alliance of anti-Bolshevik forces). The country was ravaged and destabilized. Ultimately the Bolsheviks won and in the process established "War Communism" - a provisional system during war aimed at supplying the Red Army and served as a leap into socialism (Richman 1981: 89).⁴

At the heart of this leap stood the "Great Architect" Stalin, who cemented the rudiments of a modern industrial economy in the Soviet Union.⁵ It would be Stalin's transformations that would become the enduring legacy and successive general secretaries up to Gorbachev would at best tinker with the model. The rate and comprehensiveness of Stalin's five year plans between 1928 and 1938 were not unlike the Shock Therapy between 1991 and 1996, though the former was about building and the latter about demolishing.

⁴ Refer to Appendix I

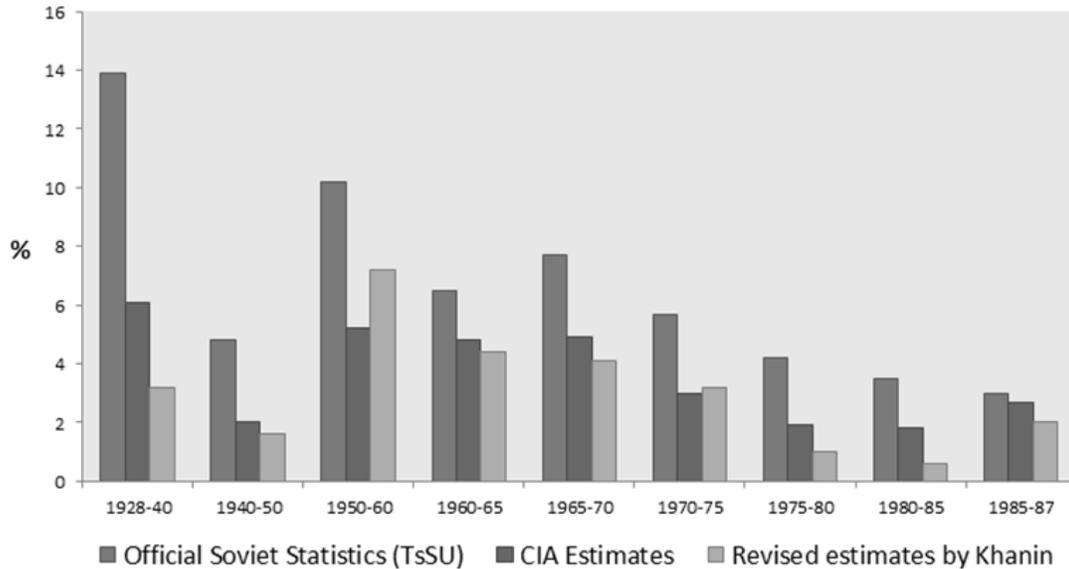
⁵ Gorbachev (2000: 24), of course, gave more credit to the millions of people in the 1930s who worked hard with patriotic enthusiasm after the Soviet revolution, during the Second World War, and in the postwar reconstruction period.

Stalin pursued industrialism by prioritizing development of industrial and military sectors. Following the Second World War, Stalin (1953: 454-458) famously stated, “We are fifty or a hundred years behind the advanced countries. We must make good this distance in ten years. Either we do it, or they crush us.” His views echoed the words of Thomas Hobbes (1651 as cited in Viner 1948: 15) that “Wealth is power and power is wealth.” Through Gosplan, the state economic planning agency, the Soviet Union embarked on ambitious goals of developing the heavy industries, especially coal, oil, steel, and electricity. In the 1930s, the Soviet Union achieved rapid urbanization and industrialization at spectacular growth rates, even while the West suffered the Great Depression. Bergson (1956: par 1) estimated,

In 1952, the dictator's next-to-last year, Soviet industry produced about 6.5 times as much as it did at the beginning of the five-year plans in 1928. In heavy industries the gains were even greater. Steel production increased eightfold to 34.5 million tons, coal 8.5 times to 301 million tons, and electric power 23 times to 116 billion kilowatt hours. In a quarter-century the U.S.S.R. became the world's second industrial Power.

Figure 1 shows the 1987 recalculation of Soviet economic growth done by Grigory Khanin, a Soviet economist. Besides the obvious information asymmetry, while the capitalist enterprises had a tendency to under-report to minimize the payment of taxes, the communist enterprises had a tendency to over-report to grease the numbers for the state and secure largest share of input materials (Aslund 2007a). It is also evident that the West had been quite incorrect in its estimations about the Soviet economy. Nonetheless, the Soviet economy experienced significant growth for several decades and certainly was not a collapsing horse in the 1980s.

Figure 1: Soviet National Income Growth, 1928-1987



Source: Gatrell, Peter, and Mark Harrison 1993: 425-452.

Stalin also pursued militarism by disproportionately allocating resources to military complexes (Aslund 2007a). Admittedly, the achievements in the military sectors were even more remarkable. Stalin’s industrial-military complex outmuscled the Nazis in the Second World War and emerged as the backbone of a new military superpower. The Russian nationalist Aleksandr Prokhanov recalled: “One could say that until the Soviet Union achieved military-strategic parity with the West, the USSR had no other national goal than that of survival and defense” (*Détente* 1987: 26. as cited in Aslund 2007b: 12). Unfortunately, heavy militarism soon became an obsession that was achieved at the cost of the Soviet agricultural and service sectors (Aslund 2007a: 13-14). By 1985, this military budget comprised 18 percent of the Soviet Union’s GDP (Ligachev 1993: 329 as cited in Aslund 2007b: 34). It is no surprise, then, that Zbigniew Brzezinski (1983: 12 as cited in Aslund 2007b: 12), a Polish-American political scientist, stated, “The Soviet Union is a world power of a new type in that it is one-dimensional . . . the Soviet Union is a global power only in the military dimension.” As

demonstrated by Table 1, at least in terms of GDP per capita levels, the Soviet Union at best one-third of the US.

Table 1: Soviet and US per capita GDP compared, selected years, 1946-91 (% and 1990 international dollars)

Years	Soviet per cap GDP as % of US	Absolute Gap (\$)
1946	20.8	7,294
1950	31.7	6,120
1953	27.8	7,806
1960	35.2	7,258
1964	34.9	8,257
1973	34.0	10,967
1985	33.5	13,335
1991	27.1	15,573

Source: Derived from Maddison 1995, Table D-1

The state was able to pursue radical economic policies - industrialism and militarism -through political repression. One advantage of a totalitarian regime over democracy was that the leader faced little opposition to pursue one’s policies, and could crush any opposition at will. One of most notable political repressions was Stalin’s *Great Purges* between 1934-1940 which were motivated by the desire to remove political dissension and consolidate power (Conquest 2008). By sheer force, rapid industrialization was laid on the backs of the peasants. Millions of people were displaced in the process of strategic buildup of new industrial cities, many of which came to specialize on single productions (Gaidar 2010). The *Kolkhoz* collectivization from 1930s to 1950s failed miserably, becoming a form of “neo-serfdom” in which the Communist bureaucracy replaced the former landowners (Ibid). Peasants were not only stripped of their lands but forced to contribute a lion share of their produces to the state, and as a result, industrial sector achieved growth at the cost of permanently damaging

the agricultural sector (Suny 1998; Sakwa 2008; Hunter 1973). In fact, all citizens suffered under a regime that discouraged consumption in favor of investments to maximize output (Gaidar 2010). Consumer-producer relationship became distorted by subsidies and the common saying went: “They pretend to pay us and we pretend to work” (Rosenblum 1997: 298). Bureaucracies bred corruption, increasingly dampening sound judgment and subsequently obstructing economic progress.

The successor of Stalin, Nikita Khrushchev, quickly denounced Stalin’s *Purges*, an act considered by many as the first *Glasnost*, but he also unwittingly heightened a different, external fear in people by escalating the conflict with the West that culminated in the Cuban missile crisis in 1962. Also, recognizing that Stalin’s economic reforms stifled innovation and prevented the system from progressing beyond the primary stages of industrialization, Khrushchev refocused state agenda from totalitarianism to economic well-being but failed at increasing the living standards, especially in the agricultural sector (Sakwa 2008).

The Successors of Khrushchev - Leonid Brezhnev, Yuri Andropov, and Konstantin Chernenko - had a common strategy of authoritarian modernization, which included fighting corruption and finding ways to rejuvenate the stagnant economic growth (Ibid). Since no single leader was ruling with Stalin’s iron fist, power struggle began creating cracks in the system. By the 1980s, the Communist Party of the Soviet Union (CPSU) was becoming increasingly polarized between Brezhnev-loyal hard-liners and the soft-liners advocating continued reforms (Aslund 2007b). As a result, state power diminished and people’s power grew precipitously in its place. By mid-

1960s 70 percent of Soviet citizens had become urban, well-educated, mobile class with greater demands and expectations on freedom and material prosperity (Suny 1998).

Mikhail Gorbachev's Diffusion of Power

When Gorbachev was elected the General Secretary of the Soviet Union in 1985, he was aware of the problems his country was facing. Alexander Yakovlev, who became the mastermind of Gorbachev's *Perestroika* and *Glasnost*, echoed their shared sentiment, "Enough! We cannot live like this any longer. Everything must be done in a new way... There has come an understanding that it is simply impossible to live as we lived before - intolerably, humiliatingly" (Aron 2011: par 17).⁶ Ryzhkov, the Prime Minister under Gorbachev, similarly lamented in 1985, "[We] stole from ourselves, took and gave bribes, lied in the reports, in newspapers, from high podiums, wallowed in our lies, hung medals on one another. And all of this -- from top to bottom and from bottom to top" (Ibid: par 19). Vadim Medvedev, secretary of the Central Committee and member of the Politburo, admitted that the eighth five-year plan (1966–71) was perhaps the last successful period in the country's socioeconomic development⁷ (Gaidar 2010: 79).

Gorbachev's initial economic reforms, "Perestroika Mark One" as referred to by historian Geoffrey Hosking (e.g. Acceleration programs), were not unlike his predecessors' policies, which comprised mostly of increasing investments, reinvestments to old facilities, and imports cuts (Dunlop 1993).⁸ Gorbachev (1987: 10 as

⁶ Refer to Figure 1. Since Brezhnev's era, economic stagnation in 70s and 80s became a serious concern of the Soviet leadership.

⁷ Refer to Appendix VI. Stalin oversaw 1st to 5th. 12th became Gorbachev's *Perestroika*. Dissolution of the Soviet Union ended the 13th plan prematurely as Yeltsin began his Shock Therapy.

⁸ Refer to Appendix II

cited in Sakwa 2008: 10) firmly believed that the system could be saved and that the “socialism had been underutilized.” Greater reforms, however, revealed only deeper bureaucratic problems in the system⁹, and Gorbachev was forced to push for further reforms¹⁰ (Sakwa 2008). At a certain point, however, Gorbachev realized that in a totalitarian regime where the political and economic systems are so closely intertwined, serious changes in economic sphere could not be made without emancipating people politically (Gorbachev 2000: 61).

It would be the “Perestroika Mark Two” – amalgamation of *Perestroika* and *Glasnost* – that would create the preconditions for the Soviet collapse (Suny 1998). Granted, Gorbachev’s aspirations were noble as expressed in the 1988 Freedom speech to the UN General Assembly,

The compelling necessity of the principle of freedom of choice is also clear to us. The failure to recognize this, to recognize it, is fraught with very dire consequences, consequences for world peace. Denying that right to the peoples, no matter what the pretext, no matter what the words are used to conceal it, means infringing upon even the unstable balance that is, has been possible to achieve (Gorbachev 2011: 17).

Glasnost policies liberalized the public media and the political structure (Dunlop 1993). In contrast to his hopes, however, liberalization of the public media served little to garner popular support for the state. An untimely cover-up of the 1986 Chernobyl disaster tarnished the public image of the state (Hoon 2013). Several propagandistic campaigns, which had been successful in the past, became increasingly repulsive to people. For example, the 1985-1987 anti-alcohol campaign was very unpopular. And despite the overall gains in the societal transformation (e.g. fall in crime rates and rise in

⁹ For example, falsification of information (Suny 1998)

¹⁰ For example, greater autonomy was granted to enterprises to conduct business under contract with the state and with each other, while workers’ rights were enlarged as well as a way to incentivize them (Suny 1998).

life expectancy), it was ultimately the state that suffered because in 1984, 17 percent of total retail sales were in alcohol and almost 90 percent of alcohol sales went to turnover taxes (Shkolnikov and Nemtsov 1997; Aslund 2007b). And while the state budget took a blow in tax revenues, the black marketers and rent-seekers reaped the benefits in its place. As demonstrated by Table 2, standards of living were declining as the economy continued to stagnate. The wages were declining while the retail prices were increasing. The state printed currency for public investments and running budget deficits.

Table 2: Soviet Macroeconomic Performance , 1985-91

Indicators	1985	1986	1987	1988	1989	1990	1991
GNP growth	0.8	4.1	1.3	2.1	1.5	-4	-13
Gross investment growth	3	8.4	5.6	6.2	4.7	-2.5	-6
Budget deficit/GDP, %	2.4	6.2	8.8	11	9.5	8.3	20
Retail price index	3.5	4.4	4.5	6	8	20	100
M2 growth	N.A.	8.5	14.7	14.1	14.8	20.2	75
Nominal wage increase	2.9	2.9	3.7	8.3	9.4	12.3	70
Real wage	-0.5	-1.5	-0.5	2	1	-6	-15

Source: Fischer 1994: 234. Growth rates reflect Central Intelligence Agency's estimates.

All the while, people began disassociating themselves from the state, whether from its appalling past or the weakened incumbent leadership, further undermining the legitimacy of the state (Sakwa 2008: 11). Aslund compared Alexis de Tocqueville's prescient words before the French Revolution to what he saw happening among Soviet people,

For it is not always when things are going from bad to worse that revolutions break out. On the contrary, it oftener happens that when a people which has put up with an oppressive rule over a long period without protest suddenly finds the government relaxing its pressure it takes up arms against it (de Tocqueville 1856/1955: 176 as cited in 2007b: 283).

More serious repercussions, however, followed the liberalization of the political structure - introduction of the Congress of People's Deputies. In 1987, Gorbachev spoke

in the Central Committee, “*Perestroika* itself is possible only through democracy and thanks to democracy. It is the only way to give scope to socialism’s most powerful creative force—free labor and free thought in a free country” (Gorbachev 1987: 317 as cited in Aslund 2007b). Although still only one organized political party was legally permitted to exist and as much as one-third of the 2,250 deputy positions were appointed by the Communist Party members (two-thirds could be nominated by various organizations diffusing power from the center) (Suny 1998). The very role of the CPSU was diminished from “leading” the country to “guiding” it (Robinson 1992 as cited in Sakwa 2008). Unfortunately, instead of garnering the Soviet republics’ support for the Soviet Government, triggered centrifugal forces began fueling nationalism and separatism.

The Soviet Union was a political system that rested on centralized political and economic decision-making of the Communist Party, enforced by the secret police, and all political and economic institutions revolved around this nexus (Aslund 2007a: 16). Gorbachev’s partial democratization wreaked havoc instead of effectiveness. His ambivalence with policies, shifting of allegiances between the hard-liners and soft-liners, also exacerbated the situation. Sakwa observed the diffusion unfolding among the party members and republics at large,

Gorbachev had planned a gradual liberalization of the regime, yet his hesitancy in relinquishing the concept of Party rule, and indeed his failure to split the CPSU... meant that as power leaked away from the old “administrative-command” system it was absorbed by the republics (2008: 18-19).

On the political end, Gorbachev could have resorted to use political repression like Stalin to stabilize the country and create order. But Gorbachev’s deep and personal

aversion to violence and refusal for mass coercion ultimately would cost him his power and the survival of the Soviet Union (Aron 2011). On the economic end, Sakwa (2008: 21) considered radical “500 days” reform proposal - end to price controls, fiscal and monetary policies to curb inflation, and rapid privatization - by Stanislav Shatalin, Giryory Yavlinsky and Yegor Gaidar (Yeltsin had sided with them) in 1990 to be the last chance to keep the Soviet economy together. Gorbachev equivocated and opted for more gradual reforms proposed by the conservatives.¹¹

Boris Yeltsin’s Reformation of Power

Arguably the most proficient adapter to and beneficiary of Gorbachev’s reforms was Boris Yeltsin. In 1985, Gorbachev appointed Yeltsin the First Secretary of the Moscow Communist Party (similar to a mayor) and in 1986 a candidate member of the Politburo. However, he soon became disillusioned with the regime during his tenure in Moscow. Yeltsin could not bear witnessing servility toward Secretary General; the abandonment of Shatalin’s “500 Day” economic reform program; the disparity between *Nomenklatura* (a select class of people appointed to government and industry posts by the Communist Party) and the public (Lewin 1989 cited in Dunlop 1993). And in 1987, in a closed Central Committee plenum, he began criticizing Gorbachev for ineffective reforms. Yeltsin was soon demoted and Gorbachev vowed to prevent Yeltsin from coming back into politics. (Yeltsin 1990: 199-201 as cited in Dunlop 1993: 11). Yeltsin never forgot and he never forgave.

Ironically, Gorbachev’s establishment of the Congress of People’s Deputies unwittingly granted Yeltsin another chance. He began a comeback by winning the

¹¹ Gorbachev was under the threat from the KGB and Kremlin hard-liners (McClintick 2005)

March 1990 elections with 72 percent of the votes to represent Sverdlovsk at the Russian Soviet Federative Socialist Republic Congress (RSFSR) and in May 1990 was elected chairman of the Presidium of the Supreme Soviet of the RSFSR (Aron 2000: 739). Vitaly Tretyakov (1989:10 as cited in Dunlop 1993: 44-45), a journalist, wrote about the Boris Yeltsin Phenomenon: "... people identifying with this ordinary person and a man of action on problems which have a direct bearing on the ordinary life of ordinary people: food, housing, social justice, and crime, especially in trade." Although Yeltsin had no KGB, no army, no administrative, state, or the Party apparatus, he had the public support, which had become a true force after *Glasnost* (Dunlop 1993).

In June 1990, Yeltsin achieved his long-desired goal when the RSFSR Congress voted overwhelmingly in favor of the declaration of sovereignty, and in July 1990, he resigned from the Soviet Communist Party in protest of one-party political system (Dunlop 1993). What had been rather paradoxical was that in a March 1991 referendum on the future of the Soviet Union approximately 71 percent of Russians voted for the preservation (Polyakov 2011).¹² Unlike the public, however, Yeltsin's endorsement of the Commonwealth of Independent States (CIS) signaled that he was in favor of dissolving the Soviet Union. But perhaps due to ambiguity in wording, the public did not withdraw their support (McFaul 2001). And, in June 1991, with the support of the RSFSR Congress of People's Deputies and a 57.3 percent margin from 74.7 percent of the population that partook in elections, Yeltsin became the first elected president of the sovereign Russian Republic (Kara-Murza 2011). And with him, the Soviet Union was supplanted by a loosely-tied Commonwealth of Independent States (CIS) – a

¹² Question: "Do you consider necessary the preservation of the Union of Soviet Socialist Republics as a renewed federation of equal sovereign republics in which the rights and freedom of an individual of any nationality will be fully guaranteed?"

supranational economic institution that was largely ineffective. From an economic perspective, the dissolution of the third largest economy was hardly a wise decision to begin with, if achieving economic growth was of principal value.

Meanwhile, on the Soviet level, the struggle for power between the hard-liners (CPSU factions against *Perestroika*) and soft-liners (CPSU factions in favor of *Perestroika*) continued. The struggle culminated in an August coup of 1991 in Moscow which lasted three days (August 19-21). It was organized by the hard-liners against the soft-liners of the CPSU. Yeltsin rushed in defense of the White House against the coup and in the process consolidated his power, while Gorbachev was effectively stripped of power. Gaidar recounted the situation after the failed August coup of 1991,

Yeltsin had a large reserve of popular trust, unimaginable responsibilities, and almost no levers of control. After all, up to this very moment the Russian republic, as a government structure, had been purely decorative. Nothing in it was connected to anything else. It had no army, no KGB, no MVD (Ministry of Internal Affairs), no control over other regions of the country... It effectively had no central bank. No control over the greater part of industry. No customs service. In fact, nothing at all, except the name - the Russian state (Gaidar 1999: 66 as cited in Aslund 2007b: 75).

Following the failed coup attempt, the leaders of the republics began dictating to the central government the terms of power between them (McFaul 2001: 130). The leaders of republics, particularly in the Baltic and Ukrainian republics, and the Georgian government were determined to declare independence¹³, while Central Asian republics were more interested in preserving the union (Ibid: 131). Yeltsin wanted to prevent the restoration of Union authority and was insistent that the constituted central government ought to be subordinated to the sovereign republics instead (Ibid: 132).

¹³ Declaration of Independence: Lithuania on February 24, 1990; Moldova on February 25, 1990; Latvia on March 18, 1990; Armenia on May 20, 1990; Georgia on October 28, 1990

As stated previously, the Soviet collapse was a deliberate breakup by the insiders (Gorbachev 2000: 92, 158; Aron 2011) and not an inevitable economic implosion as some shock therapists claim (Gaidar 2010: 96; Aslund 2007a: 16, 2007b: 4). On December 4, 1991, taking advantage of this precarious situation, Yeltsin colluded with the Ukrainian president, Leonid Kravchuk, and reformist speaker in the Belarusian parliament, Stanislav Shushkevich, to dissolve the Soviet Union and replace it with a loosely-tied CIS through the Belavezhdha Accords (Suny 1998; Sakwa 2008; Dunlop 1993).¹⁴ In hindsight, the peaceful dissolution of the Soviet Union and avoidance of the civil war were arguably the greatest achievement of Yeltsin, although Vladimir Putin (2005) in annual address in famously lamented the event as the greatest geopolitical catastrophe of the 20th century.

It is axiomatic in the literature that successful transition from authoritarian regime depends on separation of politics and economics because radical reforms simultaneously on two fronts are untenable (Gaidar 2010). But due to design of the socialist system of economic management, when the totalitarian political regime collapsed, so did the economic system (Ibid: 38). Therefore almost immediately, Yeltsin had to determine how to transform Russia's economy. Russia was facing urgent economic concerns: "Grain reserves were down to 4 months supply, foreign currency and gold reserves were exhausted, and the whole country lacked credit-worthiness" (Sakwa 2008: 292). Yeltsin focused on economic reforms even at the cost of democratic reforms (Aslund 2007b). He was committed to cooperate with the West and adopt their

¹⁴ On December 21, 1991, 11 of 12 remaining (except Georgia) Soviet republics signed the Alma-Ata Protocols which became the founding declarations and principles of CIS.

political and economic systems. His commitment was evident in his speech shortly after the failed August coup attempt in 1991,

In what kind of a country do we find ourselves? It's a country in a transitional period which wants to proceed along a civilized path traversed by France, England, the United States, Japan, Germany, Spain, and other countries. It is striving to proceed precisely along that path through the decommunization and deideologization of all aspects of the life of society, the striving for further democracy, a market economy, and all forms of property, including private property (USSR Today 1991 as cited in Dunlop 1993: 282).

Many people, including many Russian citizens, choose to blame the irresponsible Russian leadership of the 1990s that deliberately brought years of turbulence only to enrich a small cohort.¹⁵ Likewise, some people mistakenly considered Shock Therapy an imposition of the West.¹⁶ Gaidar defended that after the failed *Perestroika*, country was devoid of “choice” except to undergo harsh medication (Sackur 2008). By doing so, he implicitly justified Yeltsin’s hastening of radical economic over political reforms (Aslund 2007b).

Surprisingly enough, in the early 1990s, perhaps due to Yeltsin’s popularity, his Shock Therapy proposal was highly favored by the public (Kara-Murza 2011). According to the April 25th, 1993 Referendum, 58.7 percent stated that they had confidence in President Yeltsin and 53 percent agreed with his socioeconomic policies that began in 1992 (Rossiiskaya gazeta, 6 May 1993 as cited in Sakwa 2008: 51). Even in 1994, polls showed that the public consistently favored continuing reforms over stopping reforms by a 2.5:1 to 3:1 margin (Dunlop 1993: 324). Curiously enough, the

¹⁵ Refer to Appendix III

¹⁶ The Shock Therapy was not a result of an imposition by the West. Gaidar had studied the market economy from text books unlike the Chicago Boys. Similarly, Balcerowicz, the Polish economic reformer, who had transformed Poland a few years earlier, shared a similar background and did not know about the Washington Consensus. And still, these two economists arrived at the same conclusion with their western, liberal counterparts. Russia was determined to apply the Shock Therapy with or without the rest of the post Soviet countries (Sachs 2012).

public consistently supported Yeltsin and lifted him over his opponents.¹⁷ Parliament had also voted 876-16 in support of the reforms, though later after having seen the socioeconomic costs, they turned away from it (Aslund 2011).

With the public and parliament behind him, Yeltsin implemented the Shock Therapy to permanently transform the Soviet command economy to a market economy. He stated,

Gaidar's reform secured macroeconomic change, namely the destruction of the old economy. It was a wildly painful break, surgically crude, with the rusty grinding sound of pieces of old parts and mechanisms being ripped out together with the flesh, but the break occurred. Most likely, it simply could not have happened any other way. We had virtually nothing to work with apart from Stalin's industry, Stalin's economy, adapted to the present day. And its make-up dictated precisely that sort of a break: over the knee. The system was destroyed in the same way it was created (1994: 300).

Of course, the hard-liners, and even Gorbachev, believed that the Soviet Union could still reform but their voice had lost influence, especially after the rejection of the "500 days plan" discussed earlier.

In Yeltsin's mind, the Belavezhdha Accord marked the peaceful dissolution of the Soviet Union and with it the attainment of political freedom. Therefore, he considered economic freedom to be the next necessary step and building of political institutions a distant third (McFaul 2001: 161). His second priority, establishment of economic freedom, was going to be implemented through the Shock Therapy: "ridding the new country of all barriers to the freedom of enterprises and entrepreneurship, offering the people possibilities to work and receive as much as they earn, after having relieved them

¹⁷ As mentioned previously, Yeltsin's primary constituency that helped him defeat the hard-liners in the August 1991 coup and consolidate power to overthrow Gorbachev was the public. Unfortunately, in his pursuit of the Shock Therapy, he would abandon his constituency, especially in favor of a newly erected class of *Oligarchs*. Nonetheless, in the constitutional crisis of 1993, once again, it would be the public that would side with Yeltsin.

of bureaucratic pressures” (Yeltsin 1991 as cited in Aslund 2007b: 90). Yeltsin’s postponement of the political reforms, however, would be a misstep that he would come to sorely regret. McFaul (1995: par 11) listed Yeltsin’s missteps: “not ratifying a new constitution, not calling for new elections for either the parliament or local government officials, failed to create his own political party, and left in place several Soviet political institutions among which was the Russian Congress of People’s Deputies.” Russian Constitution of 1978 was amended in 1990 but it granted both the executive and the legislative branches supreme power (Sakwa 2008). As they wrestled for power and control, the struggle would escalate to a constitutional crisis in 1993 and almost to a civil war. The Russian Congress of People’s Deputies that Gorbachev had established was left alone and as a result, the Congress Chairman Khasbulatov would lead the parliament against Yeltsin in the 1993 constitutional crisis. Although a myriad of political parties emerged after Yeltsin, they would not coalesce with a purpose of representing people. Instead, with the ascendance of Vladimir Putin, a loyalist party United Russia would arise in order to dominate the parliament in support of the executive branch.

Conclusion

In this chapter, I have attempted to argue that the Soviet collapse was a deliberate political breakup by insiders (Gorbachev 2000; Aron 2011) and not an inevitable implosion due to economic or political contradictions. This is not to overlook the fact that the Soviet Union with its communist ideology and command economy were

problematic. Rather my objective, as summarized in Table 3¹⁸, has been to underscore Gorbachev’s decisive role in triggering centrifugal forces, which Yeltsin exploited by deliberately dissolving the Soviet Union. Soviet history demonstrates clearly that it had overcome far more difficult political and economic crises in the past than in the late 1980s.

Table 3: A Comparison of Stalin’s, Gorbachev’s and Yeltsin’s Reforms

	Diagnosis	Reforms	Political Regimes	Political Repression	Political Consensus
Joseph Stalin (1922-1952)	Underdevelopment	Radical: Collectivization & Industrialization	Totalitarian, Communist	✓	✓
Mikhail Gorbachev (1985-1991)	Economic stagnation → Separatism & Nationalism	Gradual: Perestroika I & Perestroika II	Authoritarian, Communist	✗	✗
Boris Yeltsin (1991-1999)	Political destabilization → Economic disruption	Radical: Shock Therapy 2.0	Democratic	✗	✗

Since the Soviet collapse was of political nature, its immediate remedies had to be political reforms, even at the cost of economic ones. Even though politics and economics were closely intertwined in socialism, politics always held the upper hand. Shock therapists, however, misdiagnosed the illness and subsequently misplaced priorities on economic reforms at the cost of political ones. When in reality, as Yeltsin would come to regret later, the government had to pursue political reforms, even at the

¹⁸ This chapter has focused on diagnosis. The following chapters will discuss more in detail the remaining columns. Chapter 2 discusses more in detail the reforms. Chapter 3 discusses more in detail the political regimes, political repression and political consensus.

cost of economic ones. Certainly the Chinese gradualist path has demonstrated that sustained economic growth is achievable in a centrally-planned system but at the cost of forfeiting democratization. Thus, political reforms principally refer to securing political stability and consensus and only secondarily to democratic consolidation. For Russia, which had already adopted democracy, its economic reforms were also inevitable. Nonetheless, the success of Yeltsin's economic reforms was dependent on whether or not he would be able to secure political consensus. As it became obvious later, similar to Gorbachev, Yeltsin would fail at this crucial endeavor.

Chapter 2: The Medicine

The Neoliberal Shock Therapy that Undermined Russia's Transformation

Introduction

In the 1970s, Latin American countries were transformed by the neo-liberalist “Chicago Boys” (students of economist Milton Friedman); in the 1980s, post-Soviet Eastern European transformation took place in the backdrop of the Ronald Reagan’s and Margaret Thatcher’s neo-liberalism; and in the 1990s, following the Washington Consensus of 1989, the IMF began disseminating the neo-liberalism to countries like Russia. In fact, by the time of Russia’s transition, Shock Therapy had already become a standard package prescribed to the developing countries as a precondition for rapid economic growth (Sachs 1996; Aslund 2007). Not surprisingly, the Shock Therapy was often associated with John Williamson’s Washington Consensus, which was a list of generally accepted, supposedly helpful economic policies for developing countries (Williamson 1990)¹⁹:

1. Fiscal discipline is needed.
2. Among public expenditures, discretionary subsidies should be minimized, and education, health, and public investment should be priorities.
3. The tax base should be broad, and marginal tax rates ought to be moderate.
4. Interest rates should be market-determined and real interest rates positive.
5. Exchange rates should be competitive.
6. Foreign trade policy should be rather liberal.
7. Foreign direct investment is beneficial but not a high priority.
8. Privatization is beneficial because private industry is managed more efficiently than state enterprises.
9. Deregulation is a useful means to promote competition.
10. Property rights need to be made secure.

¹⁹ Aslund (2007: 32) stated, “The radical reform program for post-communist countries followed the Washington Consensus closely, but it went further and was more specific. It is incorrect, as is often done, to equalize the two.” Actually, the shock policy preceded the Washington Consensus by almost half a century. Thus, it would be more proper to state that the Washington Consensus is rooted in the Shock Therapy doctrine.

The first five items pertained to financial stabilization; sixth, seventh and ninth to liberalization; and, eighth and tenth to privatization.²⁰ “The universal policy proposal saw the state as part of the problem, exactly the opposite with the Keynesian economics that saw it as part of a solution (Onis and Senses 2003: 264; Stiglitz 2002: 197). In reality, no such consensus existed in Washington D.C. Williamson (2002: par 5) regretted coming up with the term and defended his case, “I of course never intended my term to imply policies like capital account liberalization, monetarism, supply-side economics, or a minimal state, which I think of as the quintessentially neoliberal ideas.” Regardless of what was meant, most opponents quickly glossed over such justifications and conveniently targeted its frailties as an argument against neo-liberalism.

The Shock Therapy, nonetheless, was the medicine prescribed by the leading policy-makers of the time. The medicine referred to three radical, contractionary structural adjustment policies: i) Liberalization, ii) Financial stabilization, and iii) Privatization. Sachs (2012) asserted in hindsight that the original Shock Therapy of Latin American countries was a “Shock Therapy 1.0” and differed from the “Shock Therapy 2.0” in Russia. The original Shock Therapy (Shock Therapy 1.0) entailed only radical liberalization and financial stabilization (Sachs 2012), but later, it began embodying neo-liberalism (Shock Therapy 2.0): “the dismantling of all government intervention to establish a supposedly a free-market” (Ibid: par 22). Russia overdosed on the Shock Therapy 2.0. Yeltsin set six to eight month and Gaidar set three years as the timeframe for economic recovery, but growth followed only seven years later (Sury

²⁰ These are unwarranted interpretations of the Washington Consensus by the author and does not represent an official linkage between the Washington Consensus and the Shock Therapy

1993; Sakwa 2008; McFaul 2001: 144).²¹ In this chapter, I will argue that Russia's implementation of the Shock Therapy 2.0 instead of 1.0 undermined economic growth and democratic consolidation.

The term "Shock Therapy" was an invention of the media and a modification on Friedman's coined "shock policy." Sachs (2000) stated that Ludwig Erhard's quick liberalization of price controls and government spending cuts in 1947-48 West Germany served as an inspiration for the Shock Therapy.²² But the Shock Therapy as is now known was first pioneered in Chile in 1975 by the "Chicago Boys" following Commander-in-Chief Augusto Pinochet's seizure of power after the coup d'état in 1973, and then in Bolivia in 1985 under President Gonzalo Sanchez de Lozada. Soon after, East European countries followed suit: Poland (1990), Czechoslovakia in 1991, Bulgaria in 1991, Russia in 1992, Albania in 1992, Estonia in 1992, and Latvia in 1993 (Marangos 2004). Unfortunately, no official written articles were published in Russia and thus, the closest Shock Therapy doctrine available is the Balcerowicz Plan that transformed Poland couple years earlier.²³

The Shock Therapy had an aim of surgically removing the pre-existent economic systems and supplanting them with western-style market economy (Aslund 2007b). The conventional wisdom of the Shock Therapy was well summarized in the 1996 World

²¹ It is fair to say that the Shock Therapy implemented in Russia was only partially Gaidar's since he was ousted in 13 months from office. He began leading reforms as the First Deputy Prime Minister from March 1992 and was appointed prime minister between June 1992 and December 1992. He would come back as the First Deputy Prime Minister following the 1993 crisis in September 1993 until January 1994. Victor Chernomyrdin assumed the role of a prime minister between May 1992 to March 1998.

²² Balcerowicz (2000) considered the German case far simpler than the post-Soviet transition. While Germany had to restore the suspended capitalism, the post-Soviet countries had to break down the command economy with 90 percent state-ownership of enterprises to create a market economy from the ground up. Nonetheless, West Germany was also a transitional reform that transformed the country from an authoritarian model to a post-war free market model.

²³ Refer to Appendix IV for tenets of Balcerowicz's Shock Therapy in Poland

Development Report *From Plan to Market*: “Consistent policies, combining liberalization of markets, trade and new business entry with reasonable price stability, can achieve a great deal even in countries lacking clear property rights and strong market institutions” (WDR 1996: 142 as cited in Popov 2000). For a successful building of free market forces, shock therapists claimed that pre-existent economic forces needed to be demolished as quickly as possible in the narrow “window of opportunity” before the rent-seekers closed in. They had shown immense confidence in the invisible hand and the societies’ adaptability to the market economy.

Pillar #1: Liberalization

The fundamental right of a man in the market economy is freedom. Unlike in socialism where everyone was promised egalitarianism (social, political, and economic equity), in the market economy, equality was that of opportunity and representation before the law. In the economic sphere, this freedom translated into free trade, pricing, and enterprises for the citizens.

For seven decades, the Soviet Union functioned under central planning and that meant that there was little leeway for economic freedom. Economic decisions were dictated top-down by Gosplan (economic planning in the Soviet Union) and Gossnab (State Supplies of the Soviet Union which allocated producer goods to state enterprises). Gosplan ordered what goods and services enterprises produced and how much output is produced. Gossnab allocated the inputs (raw materials, human and physical capital) accordingly. The Soviet economy had a tendency to be monopolistic that specializes on a specific product (sometimes entire cities were specializing in one product): Seventy-seven percent of products were made by a single enterprise (Suny 1993: 490).

Government set quotas and enterprise managers fulfilled these quotas, but they had a moral hazard issue – Soviet producer and consumer subsidies bred corruption. Producers could benefit more by over-reporting inputs and under-reporting outputs to pocket the differential. In addition, the price ceilings (Maximum prices of goods and services enforced by the government in aid of consumers and to artificially keep prices down) bred black markets that satisfied the suppressed demands under the radar. Stiglitz (2002: 138) stated, “Circumventing what laws were in force, if not breaking them outright, became part of the way of life, a precursor to the breakdown of the rule of law which was to mark the transition.” Consequentially, when the free market emerged with liberalized prices, it was the black marketers that were most attuned to this new Wild East, while the rest scrambled to adjust. Jeffrey Sachs (1996: 12, as cited in Aslund 2007a: 73) warned: “Experience suggests that a quick move on liberalization following the fall of communism was important in achieving comprehensive liberalization, since delays in liberalization gave time for vested interests to form around remaining barriers to trade.” Reforms, they argued, had to be comprehensive and quick to minimize the damage that could be incurred by the rent-seekers. De Melo et al. divided liberalization largely into internal and external factors:

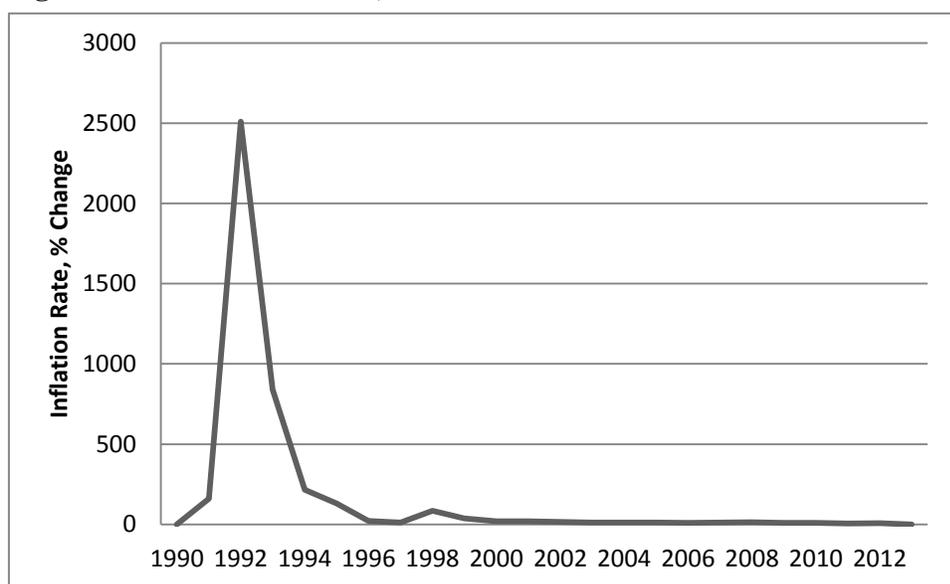
Internal liberalization comprises the freeing of domestic prices and the abolition of state trading monopolies, and external liberalization consists of the unification of the exchange rate, the introduction of currency convertibility, the elimination of export controls and export taxes, and the substitution of moderate import tariffs for import quotas and high import duties (1997: 24 as cited in Aslund 2007a: 72).

First, shock therapists pursued internal liberalization. As Popov (2000: 11) lists, Soviet Union’s centrally planned economies had peculiar domestic problems: “high militarization, over-industrialization and underdevelopment of the service sector, under-

openness of the economy, the perverse structure of trade among former Soviet republics and among socialist countries.” To fix this problem, the shock therapists contended that human and financial capital had to be freed up from inefficient and unnecessary industries and be reallocated by the free market forces. The rationale was that the “invisible hand” was better than central-planning at unleashing the full potential of the Russian economy. For this to be realized, they pushed for instant liberalization: freeing of domestic prices and the abolition of state trading monopolies.

Gaidar’s price liberalization was far reaching: 80 percent of producer prices and 90 percent of consumer prices, which immediately led to 250 percent price hikes (Aslund 2007b: 96; Suny 1993). As seen in Figure 5, total inflation in 1992 soared astronomically to over 2000 percent; remained high for four to five years; subsided but rose again in the financial crisis in 1998.

Figure 5: Russia's Inflation, 1990-2013

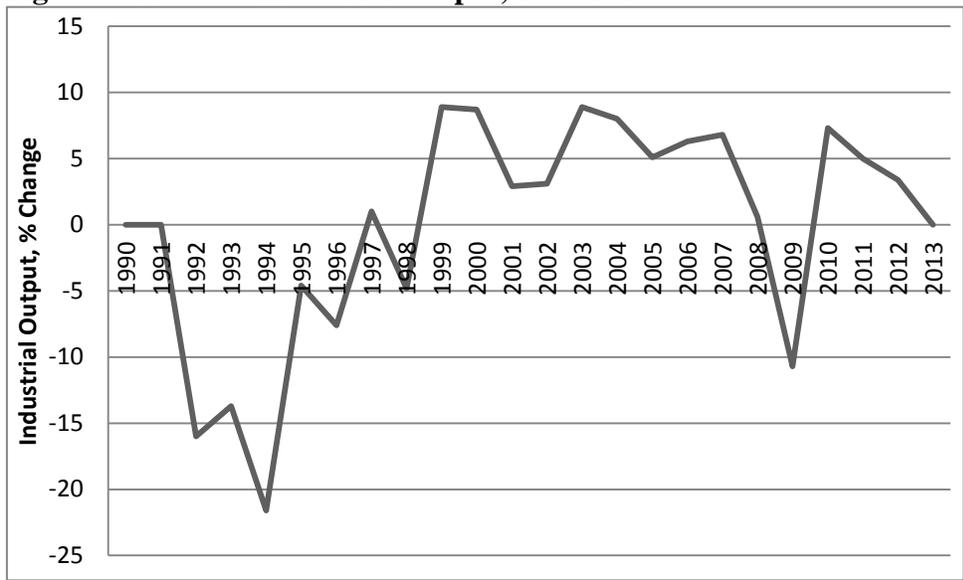


Source: Retrieved from BOFIT 2013; original data from Rosstat, Central Bank of Russia

Usually in economies struck by disruptions, the governments play significant roles in restoration. Such was the case in the United States, for example, when the New

Deal, a set of expansionary economic policies, pulled itself out of the Great Depression in 1930s. Contrary to the Great Depression (scholars have often drawn comparisons due to similar scale of economic plummet), however, the Soviet economy faced very different problems. Shock therapists maintained that its over-industrialized, distorted, and inefficient economy could be fixed only after elimination of the wasteful old production and state intervention (Havrylyshyn and Wolf 2001: 102 as cited in Aslund 2007b). Price liberalization was considered a cure to perennial shortages (Sachs 2000; Balcerowicz 2000). The rationale was that instant price liberalization would set off higher prices that in turn would motivate producers to increase their outputs toward the demand-supply equilibrium; price rises would stabilize and the economy would steadily move out of the recession (Sakwa 2008: 291). As seen in Figure 6, contrary to increasing production as had been anticipated, producers raised prices for profits and industrial output continued its decline as shortages continued.

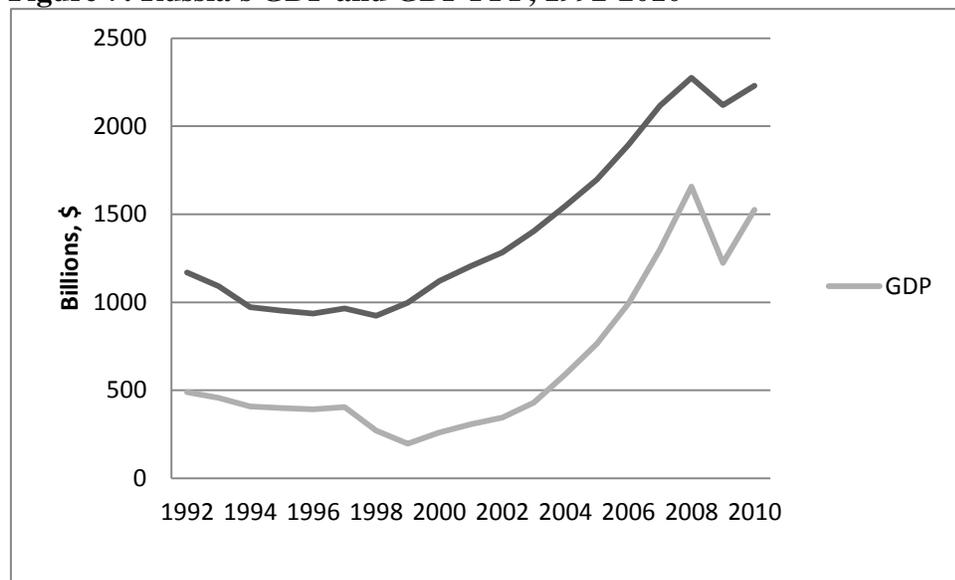
Figure 6: Russia's Industrial Output, 1990-2013



Source: Retrieved from BOFIT 2013; original data from Rosstat, Central Bank of Russia

Soon, however, it became clear that the aim of price deregulation had done more to destroy the old inefficient system rather than to construct a new efficient system. (Chubais and Vasilev: 59 as cited in Sakwa 2008: 293). The results were disappointing and painful. Between 1990 and 1995 GDP fell by some 50 percent, compared to a cumulative fall of some 31 per cent in American GNP during the Depression.²⁴ (OECD Economic Surveys: 8 as cited in Sakwa 2008: 293). As evident in figure 7, economic growth ensued only 7 years later after the financial crisis 1998.

Figure 7: Russia's GDP and GDP PPP, 1992-2010



Source: Source: Retrieved from BOFIT 2013 and original data from Rosstat, Central Bank of Russia; GDP based on PPP from Indexmundi.com and original data from the International Monetary Fund - 2011 World Economic Outlook

The Shock therapists justified their results arguing that countries like Ukraine that had taken the gradualist path fared even worse. For the Shock therapists, it was about principles and about speed, not details. They contended that gradual reforms (e.g.

²⁴ No exact comparison is available due to varying data; no one knows who is more correct. Some overstate the magnitude of Great Depression, "In the three years of economic crisis (1930-33), industrial output in the U.S.A. had sunk to 65 per cent ... Yet in this same period industrial output in the U.S.S.R. more than doubled, amounting in 1933 to 201 per cent of the 1929 output (Salil and Reid, 2008)." Some understate the magnitude of Great Depression. Industrial production of the United States decreased 46 percent, wholesale 32 percent, foreign trade 70 percent, and unemployment by 607 percent between 1929-1932 (Blum et al. 1979: 885).

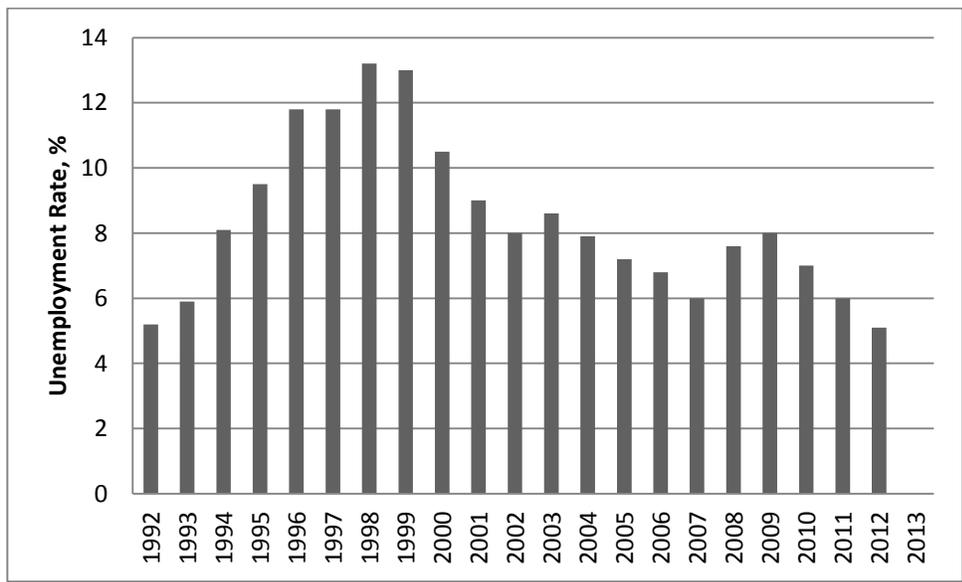
loose monetary policy, dissolution of the Ruble zone, hike in oil prices, and democratization) were the least successful policies (Aslund 2007: 7). The gradualists fired back arguing that even Britain maintained its price and other types of controls into 1950s (Sakwa 2008: 292).

There was, however, an unspoken double standard in these policies. The Western countries pushed trade-liberalization for the goods and services they exported, while protecting their domestic industries that could come under threat from developing countries (Stiglitz 2002: 60). One of such examples was the concurrent establishment of the aluminum cartel under the United States guidance. Similarly, instant deregulation of capital controls was a dangerous advice for Russia because as it would become evident in the 1998 crisis, it would become vulnerable to influx of hot money into and out of the country (Ibid: 17). Marshall Goldman (1995 as cited in Sakwa 2008: 311) went as far as to state that external liberalization instead of stimulating the supply side of Russian economy (that is, incentivize the production whether for import substitution or export promotion), sucked in imports. The efforts of reallocating resources from low-productivity to high-productivity backfired and led to zero productivity in many countries that followed IMF's advice. In hindsight, even the IMF agreed that it had pushed the liberalization too far – that over-liberalizing of capital and financial markets contributed to the global financial crises in 1990s (Stiglitz 2002: 59).

The outcomes of deregulation in January 1992 on domestic prices and abolition of state monopolies and subsidies engendered immediate consequences. The average industrial enterprise in the Soviet Union had 846 employees as compared to 163 employees on average in 6 major EU countries (Popov 2000: 19). Such a high number

was hardly surprising when considering that unemployment was virtually non-existent in the Soviet Union. Hence no safety nets such as unemployment insurance or retirement benefits were needed (Stiglitz 2002: 140). Thus, as seen in Figure 8, radical stop on government subsidies and abolition of state monopolies directly translated into rise in unemployment, and this unemployed workforce had no safety nets to buttress their dire circumstances. Subsequently, the Russian economy experienced steep decline in the production output and investments dried up. The initial stages in Bolivia, Poland, Russia and have all experienced the explosion in prices, a rapid rise in unemployment and a steep fall in production. This meant that consumers, especially the common and poor people, suffered most and their savings would be wiped. The blow was particularly hard in Russia relative to other East European countries because the Russian economy had already been suffering from distortions and stagnation.

Figure 8: Russia's Unemployment Rate, 1992-2013

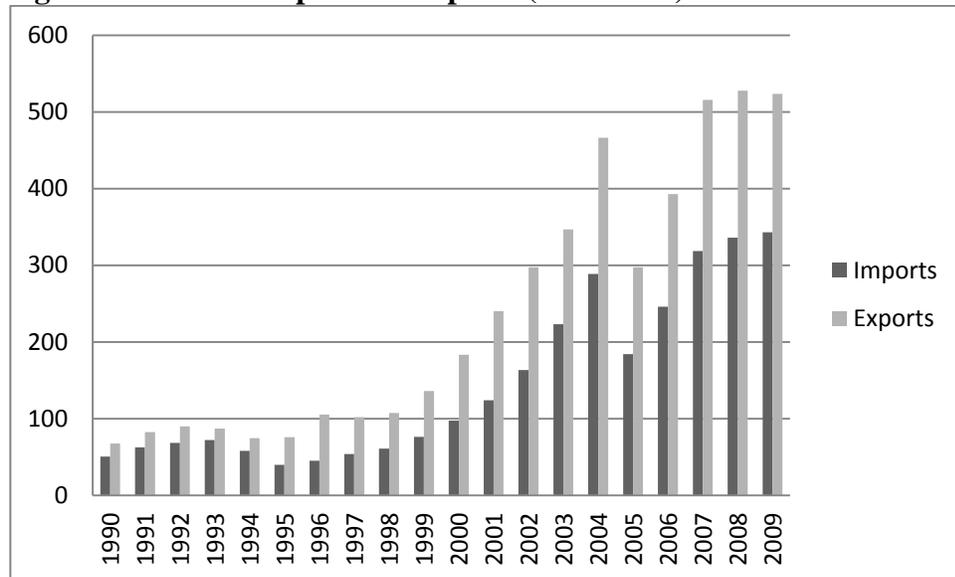


Source: Von Ritter and Tsirkunov 2013.

Second, shock therapists pursued external liberalization. Treisman (2000), proponent of Shock Therapy, observed that trade openness (increased economic

competition and economic growth) was negatively related to corruption. In November 1991, Russian Foreign trade was liberalized. The old state monopoly, which had been already liberalizing during *Perestroika*, was abolished altogether and quota was replaced with tariffs.

Figure 9: Russia's Exports & Imports (1990-2013)



Source: Retrieved from BOFIT 2013; original data from Rosstat, Central Bank of Russia

External liberalization, the shock therapists argued, would help Russia discover and capitalize on its comparative advantage in the world market. Previously, in the Soviet economy, only a few enterprises with official export quotas could engage in international trade, but up-down appointments bred corruption and limited the gains. Also, high import quotas and import duties limited imports which suppressed the potential of Russian consumers and producers. With an industrialized base and rich natural resources, Russia was thought to be ripe for international trade. Thus, external liberalization promised increase in national income and development of competitive sectors. The pre-requisite to international trade was making the Russian currency

convertible and unifying its exchange rate as well as eliminating export and import controls.

Russia demonstrated its commitment to liberalization applying to the World Trade Organization (WTO) in 1993 and finally becoming its member in 2012. Obviously, this membership promised costs and benefits. Most of all, joining the WTO signified a final integration into the market economic system, allowing Russian goods non-discriminatory access to foreign markets and protection under WTO dispute settlement procedures; Russia would automatically become a more accountable country for investors and lend a voice to it in international trade negotiations (Gaidar 2010).

The domestic industries that would suffer without the tariff barrier protection were, again, the agriculture (sickle) and manufacturing (hammer). Russia's average tariffs were remarkably low by international standards, some 11.7 per cent, and these were to be reduced even further by 2010 (Sakwa 2008: 305). As the Washington Consensus proclaimed, in the capitalist system, attracting FDI, especially from larger firms, was going to be pivotal for growth. In 2006, for example, Russia attracted \$10 billion in FDI, compared to over \$70 billion in China, and Russia's FDI totals less than 5 per cent of the total FDI that has flowed into China (Sakwa 2008: 302). This is a peculiar phenomenon since Russia followed the IMF's recommendations, while China did not and yet drew far more FDI (Other examples are Singapore and Malaysia).

Shock therapists, rightfully pushed for quick liberalization to minimize the damages the rent-seekers could make to reform efforts but they were not able to outpace rent-seekers. The Shock therapists maintained that external liberalization in Russia was

not comprehensive enough. Oil and gas prices remained subsidized and artificially low. These circumstances invited rent-seeking behavior harmful to the economy.

In late 1991, the price of 1 ton of crude oil in the Soviet Union was 50 cents, while the world market price was about \$100. Enterprise managers, commodity traders, bankers, and officials, who had exclusive access to export licenses, joined hands in a highly lucrative export of commodities. They bought commodities on their personal account at low domestic state-controlled prices and sold them abroad at world prices, cashing in anything from 10 to 100 times their purchasing price from 1991 to 1993. These huge rents financed strong opposition to the deregulation of exports (Aslund 2007a: 90).

Steven Fish (2005) listed oil among three reasons (too much oil, too little economic liberalization, and too weak of national legislature) as causes for the failure of democracy. Raw materials undermined democratization by fueling corruption. Enrichment of a new class slowed down the growth of entrepreneurs and the middle class. You and Khagram (2004: 2) observed that inequalities impede democratic consolidation: “The wealthy have both greater motivation and opportunity to engage in corruption, while the poor are more vulnerable to extortion and less able to monitor and hold the rich and powerful accountable as inequality increases.”

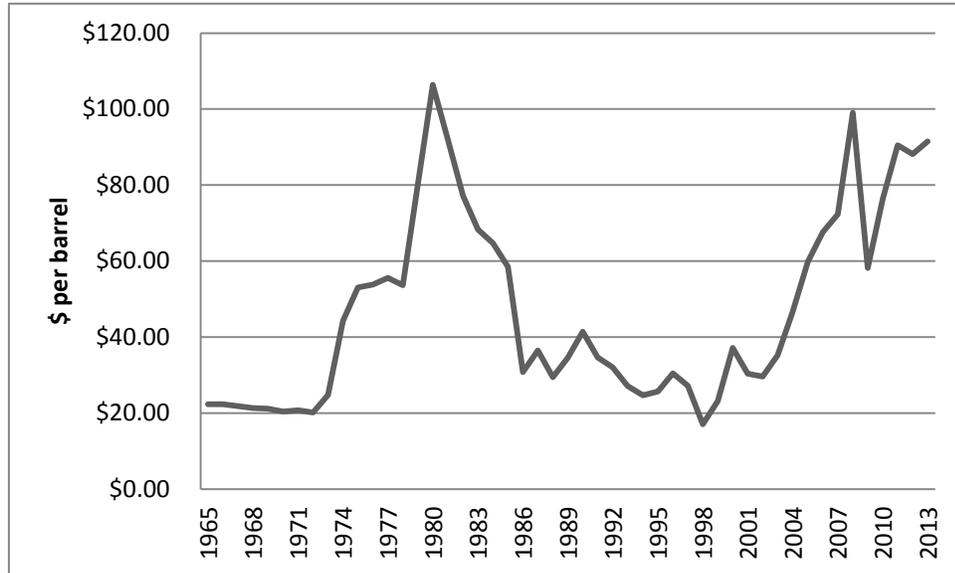
The problem has become known as the “Dutch disease” when a currency appreciates as the oil money floods into the national economy, but in the process, domestic manufacturing goods become less competitive to imports (Gaidar 2010). More importantly, the state becomes less reliant on taxes and the public dialogue or representation deteriorates which stops democratization processes; corruption rises as bureaucrats and corporations seek to pocket their shares (Sonin 2004). Moises Naim (2001), Editor of the Foreign Policy magazine and Venezuela’s former minister of trade and industry, asserts that not a single “Petro-state” has been able to make oil into a

source of prosperity for the majority of its population: “When oil revenues flood a nation that has a weak system of democratic checks and balances, dysfunctional politics and economics ensue. A lot of oil, combined with weak public institutions, fuels poverty, inequality and corruption. It also undermines democracy.”

Ironically, though, just as oil and gas served as culprit sectors during the early days of transition, they would also be the cause of upsurge of the Russian economy following the 1998 crisis. In fact, the best year since Gorbachev’s first year in the office in 1985 would come 15 years later in 2000 when Russia’s trade surplus reached \$69 billion (Sakwa 2008: 305). The trade surplus was largely a result of commodity trade boom. The oil prices were rising once again and for Russia, \$1 dollar increase in the price of oil translated into additional \$1 billion income (Ibid). It is worth pointing out that the higher oil prices were not unprecedented. There was an oil shock in 1973 when the Organization of Arab Petroleum Exporting Countries (OAPEC) announced an oil embargo in response to the Yom Kippur War. Soon after, in 1979, another oil shock occurred during the Iranian Revolution. These oil shocks have benefited the hydrocarbon-dependent Soviet economy similarly to how the rising oil prices in the first decade of 2000s benefited Russia’s resurgence. As evident in Figure 10, rising oil prices became a coup de grace that ended hyperinflation by filling the public coffers with revenue and enabled the government to stop printing money, the very source of hyperinflation (Sachs 2012). However, it would be wrong to assume, however, that Russia’s economic growth was entirely a result of rising oil prices. A study done by the Rand Corporation in 2006 estimated that about one-third to two-fifths of the growth in

the Russian economy between 1993 and 2005 could be attributed to energy rents (Wolf and Lang 2006: xii).

Figure 10: Inflation-Adjusted Annual Average Crude Oil Prices (1965-2013)



Source: BP (2012), Inflationdata (2013)

Nonetheless, channeling its pipelines westward, by 1994, Russia's trade with the EU was worth almost double that of the CIS and by 2006 represented over 50 per cent of its exports (Sakwa 2008: 305). In the auspices of high oil and gas prices, Russia was able to pay back the IMF loans ahead of schedule; furthermore, Russia felt no longer economically dependent on the West and on the reverse, securing a stable supply of energy became an objective of the EU (Mankoff 2009: 32, 151; Sakwa 2004: 12). As of 2014, Russia is the third largest trading partner of the European Union (EU) and the EU is the first for Russia; as much as 75 percent of foreign direct investment in Russia comes from EU member states (European Commission 2012).

Pillar #2: Financial Stabilization

Financial stabilization is the second tenet of the Shock Therapy. It includes monetary policies and fiscal policies. And after first round of liberalizations, financial stabilization was a necessary round to fight the inflations from the prior round. Stiglitz (2002) pointed out that immediate price liberalization in 1992 was the first mistake that set in motion a hyperinflation (double-digit inflation rates per month) that wiped out savings and necessitated a second round of monetary policies (financial stabilization) such as increasing interest rates that added to the suffering of the common people.

First, the government pursued contractionary monetary policies. These policies are aimed at curbing inflation from the liberalization by creating independent currency and contracting money supply in the domestic economy. In addition, these policies recommend maintaining a healthy exchange rate in the international economy. Although IMF had no legitimate qualifications in liberalization and privatization, financial stabilization was at the core of its competencies and more importantly the very purpose for its existence. John Maynard Keynes, one of IMF's founding fathers, described its mission in 1944: "the promotion and maintenance of the productive resources of all members as primary objectives of economic policy" (Sakwa 2008: 242). According to his demand-side economics the interdependent world economies were growing only more vulnerable to cyclical recessions, such as the Great Depression in the 1930s. He believed that an international financial institution, such as the IMF, could alleviate negative consequences of downturns by providing liquidity (the state cutting taxes and increasing its spending to provide jobs for enterprises and consumers) and thus prevent recessions from spreading across countries. Ironically, by 1989, the Shock Therapy

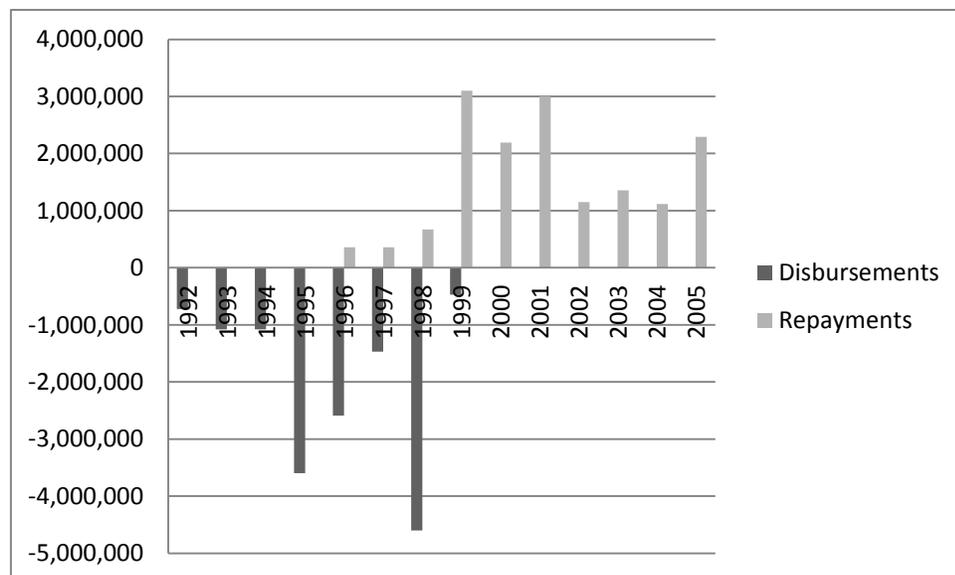
disseminated by the neo-liberal Washington Consensus made a 180 degree turn in its ideology from demand-side economics to supply-side economics propagated by Friedman and stood for decreasing public expenditures, increasing privatization, lean towards deflation, and various structural adjustment programs. But, the Shock therapists boasted that no country was able to achieve financial stabilization apart from the assistance by the IMF (Aslund 2007a: 140).

In the command economy, inflation had been suppressed by state subsidies and fixed prices. Producers were left with little incentives and leeway to make sensible decisions in meeting consumer demands. Producers greased output numbers to secure greater share of resources from Gosplan which they overused inefficiently and sometimes plainly stole; no wonder the country suffered from chronic shortages and the burgeoning black market (Gaidar 2010). The cure for economies was liberalization after which hyperinflation was a common occurrence in all transition economies (e.g. Bolivia, Poland). The state countered mounting inflationary pressures with budget cuts (including welfare and pensions); the central banks hiked interest rates to reduce the money supply. By doing so, reformers hoped to build proper incentive structure where the creative and efficient are rewarded while unnecessary and inefficient enterprises would be left bankrupt. The cost of failure (e.g. food producers from rural regions deciding to stop supplying urban cities) was going to be too high. In the mind of Gaidar, liberalizing prices was the only way to avoid even further socioeconomic problems (Sachs 2012).

To save the Ruble, IMF lent \$22.6 billion for currency exchange support (Refer to Figure 11: total transaction amounted to 15.6 billion SDRs which translated into

roughly \$22.6 billion between 1992 and 1999).²⁵ The IMF provided \$11.2 billion, the World Bank \$6 billion, and the Japanese government the rest (Stiglitz 2002: 48). Since no exact data exist, it is difficult to estimate but a great share of the funds and loans provided by the West were stolen. A study conducted by Zbigniew Brzezinski estimated 65 percent – which added up to be as high as \$18 billion per year in late 1990s and over \$100 billion by March 2000 - ended up in offshore accounts (Camden 2013). Others estimated that at least \$45 to 50 billion was expatriated between 1992-98 which prompted the Central Bank to reduce its taxes from a usual 13 percent to an amnesty rate of 5 percent (Sakwa 2008: 247).

Figure 11: Russia's Total IMF Transactions



Source: IMF 2014

Poland, one of most successful in Shock Therapy, actually ignored IMF's urges to curb inflation and left it at around 20 percent through its reform years (Stiglitz 2002: 156). Meanwhile, countries like the Czech Republic that had adhered most closely to IMF by reducing inflation to 2 percent suffered economic stagnation. Inflation is a

²⁵ By comparison, Poland received \$42.3 billion (64.8 percent of its GDP) ("Revisiting the 1989's revolutions." *Sozialistische*: par 15)

natural phenomenon and is believed to be best to mirror GDP growth. Thus, beating down inflation beyond necessity can actually do more damage than good by hindering economic growth as high interests stifle new investment.

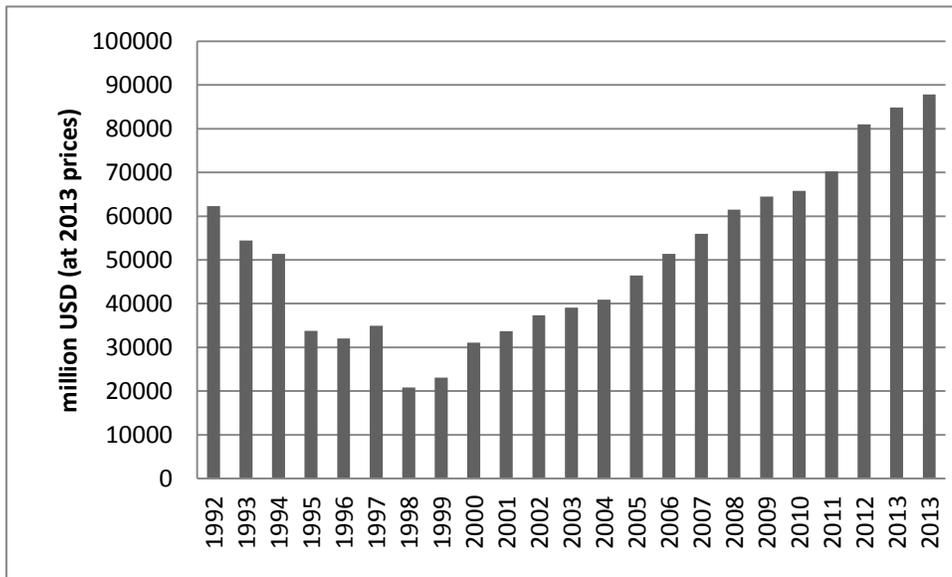
One of single greatest mistakes committed by the IMF was to press Russia keep the Ruble zone intact well into the transition years. (Aslund 2007a: 139). That is, the central banks of republics could print the Russian Ruble just like the Russian Central Bank. Essentially, the monetary controls became an obsolete tool in fighting inflation as the old Soviet State Bank and fifteen newly formed republican central banks became entangled in a prisoner's dilemma (Aslund 2007: 108). Each could benefit at the cost of the other by printing more Rubles. Unfortunately, Viktor Gerashchenko, head of the Central Bank at the time, was equally mistaken in thinking that Russia's problem was in money supply shortage and he planned to increase money supply by 30 percent every month (Sachs 2012). He was assured that more money supply would increase output and thus lead to decline in price levels.

Second, the government pursued contractionary fiscal policies. These policies aim at tackling of federal deficits by reducing public expenditures and creating tax policies. Much like the Latin American counterparts, Russia was running a budget deficit but also had inherited the Soviet debt. Sachs (2012) emphasized that eliminating the budget deficit was the most decisive measure to curb hyperinflation. To tackle the problems, the shock therapists advised contractionary fiscal policies such as reduction of government deficit and tax reforms. By economic principle, economies in recession (Russia was in a recession because the Soviet Union had been suffering from several years of recession) needed stimulus either from increased government spending or

reduction of taxes. However, for the Russian state which was in a deficit, increasing spending was not an option.²⁶

The most immediate task in balancing the fiscal budget was to cut heavily on the military sector. The military complex, however, has been notorious for being obstinate. Subduing this sector in January 1992 must have been one Gaidar’s success stories (Aslund 2007b: 7). “Military production accounted for about one-quarter of the Soviet gross domestic product (GDP) in the late 1980s” (Aslund 2007a: 5) (Refer to Figure 12 for Russia’s military expenditure). Having cut dramatically on military spending, the budget could have been channeled for safety nets or institution building. However, massive cuts did not improve the conditions in Russia because no proper institutions could uphold or fairly channel this budget. It is a mystery as to where exactly this freed-up capital leaked but the speculation is that most of it must have ended up in the *Nomenklatura*’s hands.

Figure 12: Russia's Military Expenditure (1992-2013)



²⁶ In fact, socialism was by definition a deficit economy. Subsidies ran both on consumer and producer ends. By social contract, individual rights and properties were stripped in return for stable employment and prices (Kornai 1990 as Cited in Gaidar 2010: 80).

Source: SIPRI 2013

The Soviet Union's institutions may have shared a similar name with western institutions but performed very different functions. The banking system was more of a distributor of funds as dictated by the central planners than an entity that specialized in savings or loans (Stiglitz 2002: 138).²⁷ Thus, financial institutions were uneducated and ill-equipped for their responsibilities in the market economy. This meant that effective Securities and Exchange Commission, bank regulations, and safety nets needed to be established (Ibid: 183).

As a consequence, cutbacks of government spending reduced further the standards of living in Russia as education and health among many other sectors were abandoned irresponsibly (Ibid: 154). The budget deficit would turn to a surplus only in 2000 (about \$ 6 billion) but this was achieved by oil money and low government spending. Only toward mid-2000 under Putin would the Russian government finally turn its attention to infrastructure and human capital but in comparison to earlier abandonment of health and education budgets, this belated attention would be slow and insufficient.

What made matters worse was the absence of a proper taxation system. Tax services themselves were chronically under-funded and most citizens were already stripped of their savings by hyperinflation anyway. Exploiting the weak legal system, tax evasions were rampant in the federal, regional, and even city levels. Whoever could hoard their share of the pie was busy taking out their accounts abroad to make more profit and safeguard it from the volatile Ruble. Some observers believed that the failure

²⁷ "Putin recognized that earlier policies had led to the loss of personal bank savings, and although he argued that the country could not afford to compensate savers in full, the government did apply a rolling policy of repayments, with the ultimate aim of providing recompense in full" (Sakwa 2008: 301).

to collect taxes in the 1990s forced the state to resort to short-term high interest borrowing that spiraled to the crisis in 1998 (Sakwa 2008: 300).

Another impediment to the functioning of the taxation system was barter. Contrary to what had been expected, barter that only accounted for 4 percent of industrial sales in May 1992 peaked to 54 percent in August 1998 (*The Russian Economic Barometer* 2000 as cited in Aslund 2007a). In 1997, more than 50 percent of all sales by industrial enterprises were non-monetary and over 40 percent of all taxes paid to the Russian state in 1997 were made in non-monetary forms – as a consequence of which tax was evaded and diverted from the federal to regional governments (Clifford and Ickes 1998: 1).

Russia also inherited a large pile of debt from the Soviet Union. In 1991 Russia's foreign debt was \$120 billion but it ballooned to \$150 billion by 2001 following the 1998 Crisis (excluding private enterprise debt as well as regional and local government debts). The Paris Club debt would be paid off only by 2006 (Sakwa 2008: 303). In actuality, in terms of debt statistics, however, the Soviet Union was not in hopeless situation. In 1990 Russia's debt was 10.4 percent of GDP and turned critical only during 1998 when it rose to 113 percent (Ibid). Only with the ascendance of Putin to power in 2000 did the economy enjoy seven years of prosperity with which debt levels shrank to 18 percent of its GDP in 2006 (Ibid).²⁸

Pillar #3: Privatization

Capitalism simply put is “an economic and political system in which a country's trade and industry are controlled by private owners for profit, rather than by the state”

²⁸ An average EU country carries a debt that is 60 percent of its GDP

(Oxford English Dictionary) and communism is by definition “theory or system of social organization in which all property is owned by the community and each person contributes and receives according to their ability and needs” (Oxford English Dictionary). This simplistic framework alone highlights two systems’ contrasts in ideology regarding the ownership of property. While disagreements regarding liberalization and financial stabilization were never settled, gradualists and shock therapists generally shared positive views on privatization. They agreed that privatization often helps governments suffering from deficit by freeing them to focus on most important duties such as enforcing the rule of law and collecting taxes (Stiglitz 2002). It is also true that for the most part, state enterprises have fared better in the private hands further away from bureaucracies and corruption (Aslund 2007a). In general, areas on which most scholars shared a consensus were the following (Ibid: 154):

1. Privatization had to lead to real, clearly defined, private property rights.
2. The new owners must effectively control management.
3. Economic efficiency should be promoted both within the privatized enterprises and in the economy as a whole.
4. Privatization had to be socially acceptable.

Meggison and Netter (2001: 48) conducted a longitudinal study examining vast number of studies done on privatization in the past 20 years and concluded that research supports the proposition that private firms are more efficient and profitable than otherwise-comparable state enterprises. However, they also observed that large-scale share issue privatizations (SIP) were not a major spur to modernizing a nation’s corporate governance system.

The points of disagreements concerned breadth and speed of privatization. Undoubtedly, privatization measured by percentage of GDP was not going to be

difficult to achieve, but ensuring that the transfer of ownership took place fairly and transparently was going to be more challenging. Disagreements emerged on several levels (Bush 1991 as cited in Sakwa 2008: 297):

- Some emphasized speed to maximize quantitatively the number of privatized enterprises, while others the very quality of privatization which could be achieved only by establishing institutions first.
- Some favored insiders, in whatever form, while others preferred outside investors, preferably large multinational corporations.
- Some focused on equity and the benefit to the poor, while others focused on efficiency and profit maximization.

Disagreements on privatization programs prior to execution were understandable since no one held the crystal ball but disagreements in assessment of the history-sealed facts and figures was troubling. Some heavily criticized the privatization process: “. . . privatization [in Russia] was a wasteful process associated with asset-stripping and consequent lack of legitimacy of newly established property rights” (Miller and Tenev, 2007: 543 as cited in Gehlbach and Earle 2011:1). Shock therapists considered privatization as a necessary step in the right direction, and some even hailed it as the “greatest success of Russia’s reform” (Aslund 1995, 2007: 111; Boycko, Shleifer and Vishny 1995; Shleifer and Treisman 2000). Stiglitz (2002: 186) argued that both Poland that had a head start over Russia in the market transition and China that was a less industrialized or urbanized, took more gradualist approaches in privatization than Russia. And, China and Poland were clearly more successful than Russia.

Shock therapists believed that privatization would transform Russia permanently into a market economy. Anatoly Chubais stated that the goal of privatization was “forming a broad stratum of private owners” (*Rossiiskaya gazeta* July 9 as cited in Aslund 2007b: 109). Yeltsin stated similarly in August 1992, “We need millions of

owners rather than a handful of millionaires... The privatization voucher is a ticket for each of us to a free economy” (*Rossiiskaya gazeta* August 20 as cited in Aslund 2007b: 109). They believed that privatization could resolve problems of public enterprises (e.g. corruption, monopolies, and subsidies) and unleash efficiency and innovativeness of private owners. Shock therapists lobbied for simple, comprehensive and quick privatization, property rights that would be recognized by the law (Aslund 2007b: 8).

Shock therapists pressed for quick and comprehensive privatization. Scholars like Andrei Shleifer at Harvard envisaged privatization by whatever means politically feasible, because once private owners emerge, growth would ensue and more importantly as stakeholders, they would fight for economic and political institutions to mediate and secure their property (Stiglitz 2002). That is, even if the state were to distribute property unequally, as long as it was comprehensive, it was believed that the market forces would adjust and fix the imbalances over time. For example, selling public enterprises for fractions of the value was permissible because in private hands, annual taxes would more than compensate for all the profits that could have been earned in auction sales (Aslund 2007b: 8). In addition, privatization had to be done quickly to cease that “window of opportunity” and prevent rent-seekers from closing the doors (Suny 1993). Unfortunately, according to shock therapists, privatization was not fast enough and comprehensive enough to generate best results (Aslund 2007a).

O’Donnell and Schmitter (1986: 79) observed that all previously known transitions to political democracy have observed one fundamental restriction: it is forbidden to take, or even to checkmate the king of one of the players. In other words, during the transition, the property rights of the bourgeoisie are inviolable.” Adam

Przeworski (1979: 69 as cited in McFaul 2001: 10) echoed a similar theme when he warned, “We cannot avoid the possibility that a transition to democracy can be made only at the cost of leaving economic relations intact, not only the structure of production but even the distribution of income.” In the Soviet Union, the dictatorship of proletariat was never realized. Rather, it was a dictatorship by a small ruling group at the top and a hierarchical apparatus of the *Nomenklatura* (Gorbachev 2000: 18). The elitist *Nomenklatura* system was reminiscent of the hierarchical tsarist civil service (Aslund 2007a: 20). These observations proved prescient in privatization. The experience has been characterized disproportionately by “shock” than “therapy” (Gerber and Hout 1998). *Nomenklatura* did not experience any “shock” but many were enriched in the process, some becoming *Oligarchs*. Instead, the “shock” directly hit the middle and working class citizens.

The first round of privatization of mostly small and medium enterprises was achieved through voucher privatization (1992-1994) which had served a two-fold objective of making it fast and popular in the eyes of the general public. In theory, the voucher method was ingenious as it allowed the national wealth to be distributed to all the population. The idea was attractive as workers thought it would minimize change not threatening job stability, while minimizing the risks of hostile takeover by outsiders. Each citizen was allotted a voucher worth 10,000 rubles (about \$22) which could be exchanged for shares in privatization-approved enterprises (Suny 1993: 490).

The problem was that the general public was ill-informed on how to properly use these vouchers and most reinvested in their employed enterprises or exchanged them to cash. Also, the majority of privatized enterprises were sold in workforce elections under

enterprise managers' supervision. Its employees were allowed to buy 51 percent of the enterprise stocks at fixed prices (Sakwa 2008: 297-298). Thus, the enterprise managers never lost control over their enterprise and pursued "*Nomenklatura* privatization" whereby enterprise managers and former political officials took the best of the state enterprises. Even worse, holding the levers of production, the enterprise managers threatened the collapse of industry and demanded subsidized credits from the government. They won the struggle and profited by receiving subsidized credits instead of production sales in the market (Suny 1993 as cited in Sachs 1994: 491). Then, they redirected profits to offshore accounts and foreign investments.

The second round of privatization of larger enterprises was achieved through the most controversial loans-for-share (1995-1996). In 1995, the government was suffering from severe fiscal deficit and Yeltsin's support had dried up due to prolonged years of recession, not to mention that he needed funds for the 1996 presidential elections. The government adopted a loans-for-share scheme, which was proposed by a banker, Vladimir Potanin, and supported by Anatoly Chubais. Essentially, a loans-for-share scheme was privatization of the largest state enterprises to Yeltsin's loyalists. Some state enterprises privatized through the loans-for-shares program were Norilsk Nickel, YUKOS, LUKoil, Sibneft, Surgutneftegas, Novolipetsk Steel and Mechel by means of lease auctions (Cheloukhine and King 2007: 3). These were highly controversial and unpopular privatization schemes because they were non-transparent and highly political.²⁹ The reason was clear: the government had no intention of involving the public and the procedure was corrupted. Obviously, the general public had no funds to

²⁹ At least by measure of quantity, though, Russia achieved privatization at a remarkable pace (Sachs 1994: 283).

participate in the first place³⁰ but neither did these loyalists. This scheme would create the now-known class of Russian *Oligarchs*, loyal to the president but detached from the people. The government provided highly concessional loans to them and sold state enterprises at the fractions of their actual worth. The *Oligarchs* did much damage to the Russian economy. Insecure about their property rights, they engaged in rampant asset stripping rather than building them up (Ibid). Some referred to Russia as the Wild East and the loans-for-share scheme as “grabbing” (*prikhvatizatsiya*, a pun on the Russian word for privatization) of public wealth (Sakwa 2008: 297).

By early 2001, 130,180 enterprises formerly owned by the state had been privatized, representing exactly two-thirds of the total (Sakwa 2008: 298). Concentration of the Russian economy, the very objective of privatization, was undermined: if in 2000 1,200 companies produced 80 per cent of GDP, by 2006 fewer than 500 were producing the same amount (*Izvestiya*, 12 July 2007 as cited in Sakwa 2008: 313). The Oligarchic capitalism was unevenly distributed among people and even geographically with as much as 70 percent of capital clustered in Moscow (McFaul 2001: 318). Sachs (2012) had been insistent that large natural resource companies should remain in state hands to ensure that the Russian Government got the revenues from the production of metals, hydrocarbons, and other valuable commodities, but this went unheard. Ultimately, corrupt loans-for-shares program greatly undermined the Shock Therapy in Russia. The privatization was not fully legitimized and the established Russian capitalism was fragile. The rent-seeking insiders (who were supposed to be kept away from the process) acquired majority shares in two-thirds of Russia’s privatized and firms, state subsidies still accounted for 22 percent of Russia’s GNP, little if any

³⁰ Their savings were wiped out due to inflation in 1992 and 1998. Refer to Figure 5 and Appendix VI

restructuring (bankruptcies, downsizing, unbundling) had taken place within enterprises, and few market institutions were erected (Suny 1993: 491). The general public opinion eventually swung from feeling positive at the beginning to feeling cheated.

Shock Therapy in Russia

To be sure, success of the Shock Therapy is contingent upon what is meant by “success.” If by success, the shock therapists meant preventing retrenchment of communism, then, they have succeeded. Also, if by success, they meant preventing the economy from complete collapse, they have succeeded once again. The measuring stick of success that I use, however, reflects the very objectives the shock therapists laid out to win the contract over the gradualists in the early 1990s. What the shock therapists meant by “success” was establishment of preconditions for economic growth and democratic consolidation (Aslund 2007; Stiglitz 2002; Sachs 2000; Friedman 2000; Balcerowicz 2000). By their self-defined criteria, the shock therapists have most definitely failed.

So, why has the Shock Therapy in Russia failed? Scholars have poured over this question soon after the debate on the choice of medicine subsided and effects of the Shock Therapy became evident (Hass 2011). Some have deemed the idea of building capitalism in Russia altogether unwise (Reddaway and Glinski 2001). Stiglitz (2002) blamed the IMF and the US Treasury for providing erroneous advice. Clifford Gaddy and Barry Ickes (1998) claimed that barter which diverted taxes from the federal government to regional governments and shadow economies undermined the Shock Therapy. Aslund (2007a) blamed unsustainable fiscal deficit and the debt burden for the Shock Therapy’s failure.

Admittedly, soon after the Soviet economic disintegration, the Shock Therapy 1.0 became inevitable. That is, internal liberalization and financial stabilization were necessary measures to counter shortages and inflation that quickly encroached on Russia. These measures were aimed at depoliticizing Russia to break down the Soviet remains and establish free market economy. But, without a doubt, the socioeconomic costs were high: Russia turned into a Wild East, a land of mafias, with no military or policing authorities to enforce the law. And while central government attempted to depoliticize, regional and local governments politicized even more to reap the “rents” together with their enterprise accomplices that undermined the Yeltsin’s initiatives. Similarly, external liberalization (e.g. opening up of capital account) was supposed to attract foreign investors, but only accelerated capital flight. The promised economic growth was delayed for seven years as Russians suffered under deep economic stagnation. Nonetheless, the rudiments of a market economy were established.

The most problematic was the neoliberal implementation of the radical privatization, particularly the loans-for-share program. With public support dwindling and hard-liners ascending in power, Yeltsin raised a class of *Oligarchs* to be re-elected in 1996 and prevent communist retrenchment (Gaidar 2000). Shock therapists equated the Russian *Oligarchs* to 19th century American barons like the Harrimans and Rockefellers, but Stiglitz (2002: 160) dismissed the comparison stating that while American barons, while enriching themselves, still created wealth for the country, but Russian *Oligarchs* exploited Russian assets and left the country poorer. One of most profound ironies was that while a group of Russians were becoming billionaires, the state was unable to pay pensioners their \$15 monthly pension (Stiglitz 2002: 145,

159).³¹ These unequal distributions seriously undermined democratic consolidation in Russia.

Shock therapists have considered capitalism and democracy as two sides of the same coin. For them, economic liberalization and democratization moved together (Popov 2000: 6).³² Critics have thought otherwise, of course. John Kenneth Galbraith, gradualist, opposed radical reforms and rejected its associations with democratization stating,

The fall in production is matched by spiraling prices and the population sees its savings disappear and endures yet more suffering. Living standards, already low, plummet, and tight budgetary constraints means that there is a lack of funds to provide adequate social security for the growing army of the unemployed and needy. The sheer speed of the transition intensifies the suffering and the whole fragile tissue of democratic institutions is placed under almost intolerable strain. (1990:1-12 as cited in Sakwa 2008: 291)

The fact that Shock Therapy undermined economic growth and democratic consolidation is elucidated through a closer examination of how the medicine influenced each class. Seymour Martin Lipset (1963 as cited in Rueschemeyer, Huber and Stephens 1992: 6-8), considered the upper-class and especially the lower-classes (e.g. peasantry and rural workers) as enemies of democracy, and considered urban working-class and middle-class the harbingers of democracy. The rationale was that when the power becomes concentrated with the rich and the rest are the lower-class, disparities would lead either to *Oligarchy* or tyranny. The upper-class desires to maintain its exclusive status and democratization means that they may have to lose cheap labor supply. And it

³¹ “In 1989, only 2 percent of those living in Russia were in poverty. By late 1998, that number had soared to 23.8 percent, using the \$2 a day standard. More than 40 percent of the country had less than \$4 a day, according to a survey conducted by the World Bank” (Stiglitz 2002: 153).

³² Przeworski and Limongi (1993) have conducted a longitudinal study and concluded that the claim that democracy is the most suitable system leading to economic development is rather inconclusive in the existing literature. Amartya Sen (1999) has gone further to dismiss this correlation altogether.

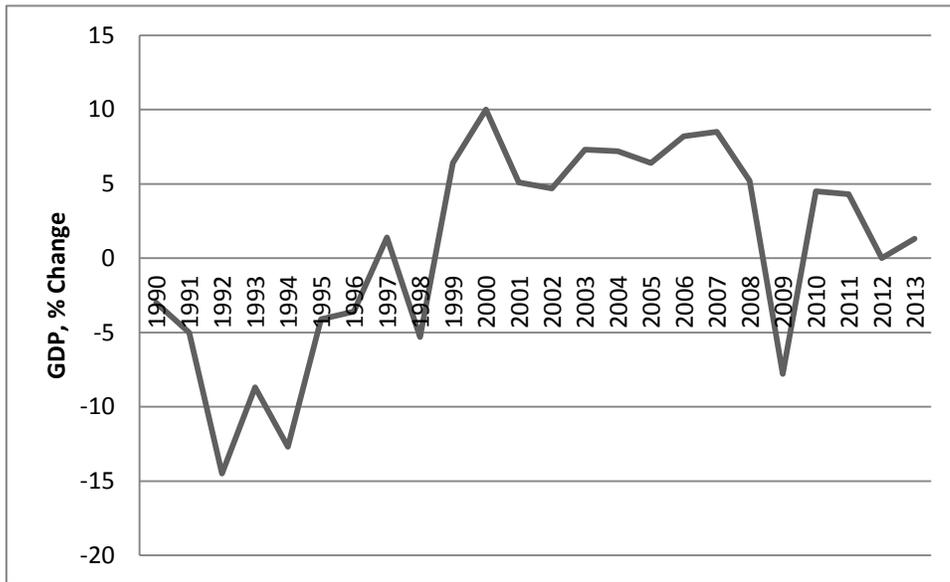
is the urban working-class that becomes the primary promoter of democracy because it views democratic inclusion in polity as means to opening up the ladder toward higher social status. However, the middle-class often plays ambiguous game in the creation and consolidation of democracy by siding with the class that best suit their immediate interests. They side with the working-class only when their interests become severely compromised by the upper-class. When threatened by popular pressures, however, they side with the upper-class in favor of authoritarian path.

Sakwa concluded that a sign of sustained economic growth is when the middle class emerges as an active part of the economy.³³ The middle-class, he maintained, marked the difference between Poland's success and Russia's failure: "Political stabilization in Poland was based on the rise of a middle class that provided some 60 per cent of the country's GDP, while in Russia whatever advances had been made by the middle class were knocked back by the August 1998 crisis and were only slowly restored thereafter" (Sakwa 2008: 474). As Figure 4 demonstrates, the Russian GDP dipped twice, making it exceptionally difficult for middle and working class people. Konstantin Sonin (2004) noted, "The trouble is that, from the point of view of its democratic stability and the ability of its political system to correct its own flaws, Russia is a borderline state. It is too rich for a Chinese or Korean-style modernization – and too poor to resist politicians' attempts to embark on that path." Its strategy has remained largely unchanged since the economy began exporting hydrocarbons in the 1960s (Gaidar 2010). The bad side of this has been that there has been little impetus to develop or nurture other industries. In effect, the government has done little to ensure a good

³³ Przeworski and Limongi (1993), unlike Lipset, observed no direct linkage between economic growth and democratic consolidation. In case of Russia, linkage becomes irrelevant, since neither economic growth nor democratic consolidation were achieved in the given time frame anyway.

environment for the middle class – their enterprises and innovation. Rather, the petro dollars have disproportionately enriched only a small cohort and consolidated Russia as a rentier state. All the while, the Russian economy remains vulnerable to oil prices.

Figure 4 Russia's GDP performance, 1990-2013



Source: Retrieved from BOFIT 2013; original data from Rosstat, Central Bank of Russia

Nonetheless, shock therapists were convinced their reforms transformed Russia for the better. Shleifer and Daniel Treisman (2003), proponents of the Shock Therapy, asserted that Russia is a “normal country.” Russia was in 1990 and 2003 a middle-income country, with GDP per capita around \$8,000 at purchasing power parity according to the UN International Comparison Project.³⁴ These middle-income democracies, if they are democracies in the first place, are states high in corruption, politicized judiciaries, illiberal press, high income inequality, concentrated corporate ownership, and turbulent macroeconomic performance. The libertarian economist Andrey Illarionov concurred speaking of Russia’s income differential stood at 14:1

³⁴ It is a comparable level to Argentina in 1991 and Mexico in 1999

(income of the top 10 percent in comparison to the bottom 10 percent) which was far better than Brazil's 50:1 (Sakwa 2004: 247).

Conclusion

In this chapter, I differentiated shock therapy 1.0 and shock therapy 2.0 by extrapolating on the three pillars of reforms. My main argument has been that the Russian economy received an overdose of the medicine, namely, Shock Therapy 2.0. The main difference between the shock therapy 1.0 applied to Latin American countries and the shock therapy 2.0 has been the neoliberal ideology in rapid privatization. Granted that economic urgencies left Russia with no option but to pursue liberalization and financial stabilization, the corrupt, large-scale loans-for-shares program greatly undermined the Shock Therapy efforts in Russia. Instead of achieving economic growth, the economy double-dipped into a crisis in 1998 and instead of democratic consolidation, a newly-created class of Oligarchs sided with the Russian government alienating the rest of its citizens from polity.

Chapter 3: The Doctors

Insufficient and Incompetent External Help and the Lack of Internal Political Consensus and Control

Introduction

Doctors' roles are critical to the success of a surgery. This chapter examines the role that each doctor played in the economic reforms and assesses the success of each. There were four main doctors in the Russian transformation. I will discuss each group in detail in the ascending order of significance: independent foreign advisers, the IMF, the United States/the US Treasury Department, and the Yeltsin's administration (Aslund 2007a). The first three were external and only the fourth was an internal group. Although much can be blamed on external entities, it was ultimately the lack of internal political consensus and control that undermined the economic reforms the most.

For the most part, external help was insufficient and incompetent. With a possible exception of Shleifer, who orchestrated the loans-for-share program with Chubais, external independent advisers had little influence in Russia (Sachs 2012; Wedel 2001). The IMF was given a crucial role but proved incompetent in handling Russia's wide-ranging economic problems, not to mention that many of its macroeconomic policies were flawed (Stiglitz 2002). Meanwhile, arguably the most influential group, the Clinton administration, deliberately prioritized disarmament of the post-Soviet space and prevention of communist retrenchment over helping Russia build a market economy and democracy (Rice 2000).

Yet, the biggest blow to reforms was the Russian government's lack of political consensus and control over its country. Yeltsin's Russia was a weak democracy meaning that governance over other powerful factions such as the industrial complex

(e.g. large energy companies), the military, the KGB (security agency) and regional governments was untenable, (Dunlop 1993; Mankoff 2009: 56).³⁵ Without overarching control over the country, reform efforts were greatly slowed down and sometimes even obstructed. The most notable struggle was between the parliament and the president. In 1993, the two would get entangled in a constitutional crisis that not only seriously damaged reform efforts but almost pulled the country into another civil war. Overall, I contend that due to lack of internal political consensus and control over the country and insufficient and incompetent external assistance, the Shock Therapy failed to create preconditions for economic growth and democratic consolidation.

The Shock Therapists vs. Gradualists

The overarching debate between the shock therapists and gradualists across all four groups concerned the speed of reforms. Should Russia take a “soft landing” gradualist approach or radical Shock Therapy approach? The two proverbs characterized the contrasting views: “Haste makes waste” versus “You cannot pass a chasm in two leaps” (Aslund 2007a). The main concern among shock therapists was the imminent danger of backsliding into communism, and the main concern of gradualists was the failure of Shock Therapy that would undermine the support for market reforms (Stiglitz 2002: 167). Essentially, the shock therapists won the discussion in all four groups. Or more accurately, the Shock Therapy 2.0 won the debate across all four groups.

Unfortunately, the measure of speed was rather ambiguous (Ibid). There was a lack of mutually-agreed upon time frames and set of expectations, which complicated measuring and assessing the efficacy of Shock Therapy. For instance, some scholars

³⁵ All of these factions were organized on an all-union basis and deeply conservative (*The Economist* 1991 as cited in Dunlop 1993: 34).

pushed for gradual reforms meaning 5 years while others for radical reforms meaning 5 years (Ibid: 183). Curiously, Gorbachev's gradual reform program, the *Perestroika*, was a four year program (Kissinger 1991 as cited in Dunlop 1993: 7). Gaidar's Shock Therapy was designed as a three year program, merely one year longer (Sakwa 2008: 292). The independent external advisor Sachs (1994: 274) provided arguably the most comprehensive and clear timeframe for the Shock Therapy: "If financial stabilization can be accomplished in the first year of radical reforms, and systemic transformation in the first five years, the structural change in the economy is a task of one to two decades." And the general consensus on the Shock Therapy's economic goals were "... the stimulation of economic activity, the modernization of the structure of industry, competitiveness on world markets, rising living standards, a stable and convertible currency, and budgetary stability" (Sakwa 2008: 311).

The IMF and the US Treasury as well as Aslund and Shleifer were in favor of the Shock Therapy 2.0 and Sachs in favor of Shock Therapy 1.0. Aslund (2007a: 305) assessed in hindsight that in Russia "Market economic reforms have been highly successful, whereas democratization has been only partially auspicious, and the introduction of the rule of law even less so." Five years into the Shock Therapy in the post-Soviet Eastern Europe, Sachs (1994: 275) assessed that countries with the most radical reforming went furthest in restoring stability and laying the foundations for better standards of living.³⁶

³⁶ In his assessment, not only Poland but also Czech Republic, Slovenia, and Estonia were a testament that radical reform is the right way to transition away from the Soviet economies. By contrast, he contended that countries that undertook gradualist reforms lagged behind. He listed Eastern countries like Hungary, Slovakia, Bulgaria, Romania and former Soviet Union countries like Uzbekistan and Belarus.

On the other side were the gradualists, who favored sequencing and slower paced reforms. Gradualists pointed to heavy socioeconomic costs, such as high unemployment, prolonged recession, and decline in GDP, and argued that such heavy costs posed many dangers to a country (Suny 1998). Nobel Laureate Douglass C. North (1994: 359) was skeptical about radical reforms when he said,

[Radical reform] is simply an inappropriate tool to analyze and prescribe policies that will induce development. While the rules may be changed overnight, the informal norms usually change only gradually... transferring the formal political and economic rules of successful Western market economies to third-world and Eastern European economies is not as sufficient condition for good economic performance.

Therefore, the primary task, they maintained, was creating institutional infrastructure for a market economy and leaving the privatization a secondary (Stiglitz 2002: 182).

Doctor #1: External Advisers

Among key independent external advisers was Anders Aslund, director of the Stockholm Institute of Soviet and East European Economics; Andrei Shleifer, Russian-born Harvard professor of economics and project director of the Harvard Institute for International Development for Russia (HIID); and Jeffrey Sachs, Harvard professor of economics and director HIID between 1995 and 1999 (Nelson and Kuzes 1994; McClintick 2005). Aslund was an advisor between 1991 and 1994; Sachs between 1991 and 1994; Shleifer between 1992 and 1997. Later, Joseph Stiglitz joined in: he served in the Clinton Administration's Council of Economic Advisors between 1992 and 1997, and in the World Bank as the Chief Economist between 1997 and 2000, where he became the most outspoken critic of the IMF and the US Treasury Department.

Admittedly the independence of these external advisors was a highly subjective matter due to a high degree of connection across external groups. Their independent status has come under scrutiny. Wedel (1998) referred to Sachs, Shleifer, Summers, and Lipton together as the “Harvard Boys” since they were from Harvard and worked closely together. Summers and Sachs were close colleagues from Harvard. Summers worked at the World Bank at the time (1991-1993) and later in the US Treasury (1995-2001). It was Summers who helped his protégé, Shleifer, get appointed to the position of an advisor to Russia (McClintick 2006). Similarly, Sach worked closely with his protégé, David Lipton, who between 1993 and 1998 worked in the US Treasury Department.³⁷

Because of the interlinked connections, it is difficult to assess to what extent the external advisors were able to impact Russian reforms. Again, the assessments are bound to be subjective and vary case-by-case. Sachs (2012) considered his role minimal in Russia. This was so because he advised Gaidar, who was dismissed 13 months into the Shock Therapy, with macroeconomic reforms. Shleifer, on the other hand, who advised Chubais in privatization, played arguably a larger role. He represented the HIID, which became the main consultancy group to the Russian government on behalf of the USAID, in Russia (Wedel 2001: 128). It was at HIID that the idea of voucher privatization was first introduced (Aslund 2007b). Furthermore, Shleifer worked closely with Chubais in the loans-for-share privatization program that permanently transformed property relations in the country. The role of HIID was crucial to the US assistance to Russia not least because of awarded \$57.7 million from the USAID, but also because it

³⁷ David Lipton serves as the First Deputy Managing Director of the International Monetary Fund as of September 1, 2011 (<http://www.imf.org/external/np/omd/bios/dl.htm>).

had control over the \$350 million that President George W. Bush earmarked for US assistance via the Freedom of Russia and the Emerging Eurasian Democracies and Open-Market Support Act (McClintick 2006; Wedel 1998). It was Shleifer who seriously discouraged US assistance to Russia by secretly investing in Russian securities while leading the project, in violation of HIID and US government conflict-of-interest rules (Sachs 2012). When the US government found out, it sued Harvard University. In 2005, settlement was reached with Harvard paying \$26.5 million in fines and Shleifer paying \$2 million (McClintick 2006). I believe that more than the monetary value, such a fraud made the US government more reluctant and skeptical about assistance to Russia.

Concerning the reform advice, the debate was between the shock therapists and gradualists. Proponents of the Shock Therapy 2.0 that pressed for neoliberal policies won the debate. Essentially, they saw the government as the problem and prioritized depoliticizing the economy as quickly and as comprehensively as possible. Anatoly Chubais' primary advisors, namely, Maxim Boycko, Andrei Shleifer, and Robert Vishny, who favored Shock Therapy 2.0 (1995, 10–11, as cited in Aslund 2007b: 108) summarized their conclusion in a publication *Privatizing Russia*:

At least in Russia, political influence over economic life was the fundamental cause of economic inefficiency, and that the principal objective of reform was, therefore, to depoliticize economic life. Price liberalization fosters depoliticization because it deprives politicians of the opportunity to allocate goods. Privatization fosters depoliticization because it robs politicians of control over firms.

Sachs (2012: par 53) who opted for Shock Therapy 1.0 also believed in liberalization and privatization but put a greater emphasis on safety nets, state ownership of natural resource companies, and foreign assistance. He considered that only two

recommendations - price liberalization and commercialization of enterprises - of his seven were achieved in Russia (Ibid: par 51).

1. Immediate price liberalization
2. Immediate tightening of money supply and subsidies to firms
3. Strong safety nets (e.g. the health care system)
4. Large-scale and timely foreign assistance
5. Commercialization of its enterprises by turning them into corporations with state ownership
6. Privatization quick but transparent and law-based
7. Large natural resource companies remain in state hands to ensure the Russian government received revenue

Sachs was especially outspoken about the necessity of large-scale and timely foreign assistance. He estimated that \$5 billion stabilization fund, \$15 billion annual assistance through grants and highly concessional loans, and Soviet-era debt relief would help Russia implement the Shock Therapy through the tumultuous times and create the preconditions for growth and democratic consolidation (Ibid: 40). Yet, obviously, the assistance was negligible in comparison to what was needed.

Then, there was Stiglitz (2002: xi) who propagated gradual reforms. Unlike other groups, Stiglitz did not see the government as the problem but as a crucial part of the solution. And as much as he supported many of the Shock Therapy policies, he claimed that without sequencing reforms and building proper institutions first, economic policies would falter. He analyzed that as the first two pillars of Shock Therapy (liberalization and stabilization) failed, they put obstacles for the third (privatization) (Ibid: 143). Unlike Sachs, he maintained that Russia was a resource-rich country that could either pull itself out of trouble independently or no amount of loans was going to save it (Ibid: 149). The deterrent, of course, was corruption and Stiglitz did not deem it wise to provide loans to a country that had no institutional capacity to transparently and wisely

allocate these loans. For example, over the span of 1992-1999 IMF lent over \$23.7 billion but at the same time the capital flight amounted to at least \$45-50 billion (with as much as 30 percent of that illegally) each year between 1992-1998 (Sakwa 2007; Odling-Smee 2004).³⁸ Critics charged the western investors and oligarchs with complicity and money laundering (Bishara 2012; Bedirhanoglu 2004). Stiglitz (2002: 163) assessed the outcomes:

The radical reformers in Russia were trying simultaneously for a revolution in the economic regime and in the structure of society. The saddest commentary is that, in the end, they failed in both: a market economy in which many old party *appartachiks* had simply been vested with enhanced powers to run and profit from the enterprises they formerly managed, in which former KGB officials still held the levers of power. There was one new dimension: a few new oligarchs, able, and willing to exert immense political and economic power.

In some sense, no one was so outspokenly critical of the West from the West as he was. Stiglitz (2002: 166, 170) openly criticized the US Treasury and the IMF for entering into the political arena of Russia by their unconditional support for Yeltsin and Anatoly Chubais. He contended that the West's long term interests would have been served better had they stayed out of close involvement with particular leaders, and provided broad-based support to democratic processes. This could have been done by supporting young and emerging leaders in Moscow and in the provinces who were against corruption and who were trying to create a true democracy (Ibid 171). He also criticized the double standard that the US imposed on Russia by advocating liberalization and denuclearization, while simultaneously being at the center of creating a global cartel in aluminum and giving monopoly rights to US monopoly producer to import enriched uranium (Ibid: 178). Nonetheless, however, as described, external

³⁸ Refer to Figure 11

independent advisors with a possible exception of Shleifer had little influence in Russia (Sachs 2012; Wedel 2001).

Doctor #2: The International Monetary Fund

In the early 1990s, the IMF recommended Russia to move quickly as possible with all key changes, especially liberalization, macroeconomic stabilization, and privatization³⁹ (Odling-Smee 2004). Overall, the IMF concluded in a report that its influence over the Russian Shock Therapy was modest: “It had only a limited impact on overall fiscal policy and the major structural reforms, but it had a positive impact on monetary policy” (Odling-Smee 2004: 1). Stiglitz (2002: 128) interpreted as IMF finally admitting to its faults concerning fiscal policies but keeping silent concerning monetary policies. Since the blunders in East Asia, IMF’s position shifted from short-term stabilization to longer-term structural and institutional reforms because it finally learned that neoliberal policies are infeasible for countries without proper infrastructure (Onis and Fikret 2005).⁴⁰

IMF’s fiscal policy recommendations were problematic. As a result of contractionary policies Russia’s GDP dipped but failed to generate preconditions for growth within the given timeframe. Russia’s GDP in 2000 was less than two-thirds of what it was in 1989 (Stiglitz 2002: 152). IMF had also encouraged Russia to take out foreign loans to temporarily finance the deficit. As a result, Russian debt increased from \$65.3 billion in 1991 to \$110 billion by 1997, but debt financing did not accelerate growth (Sakwa 2004: 245). It would take eight years of growth after the financial crisis

³⁹ Refer to Chapter 2 for more detailed explanation under “Liberalization” and “Financial Stabilization” sections

⁴⁰ Some scholars have attributed the name post-Washington Consensus to this shift in position.

in 1998 before Russian GDP recovered to the 1989 level and pay off the debts (Sakwa 2008: 241).⁴¹

IMF's monetary policy recommendations were similarly problematic. They encouraged keeping the currency artificially afloat through IMF-provided funds. This was a highly contended advice. Stiglitz (2002: 169-170) recalled,

Many were concerned, for instance, that the high exchange rate was suppressing growth and they were right. Others worried that devaluation would set off inflation and they too were right. These are complicated matters, and in democracies, they need to be debated and discussed. Russia was trying to do that, trying to open up the discussion to different voices.

These were difficult questions that needed cooperation not polarization. The IMF bailout was given under the condition that Russia would use it for the exchange rate support. The rationale was to contain inflation. Shock therapists feared that devaluation of the currency would exacerbate inflation. However, the currency was already overvalued and exchange rate support was “simply bad economics” and made little sense (Ibid: 148). In effect, overvalued currency led to flooding of imported goods as domestic production lost its competitiveness. In six years Russia's productive capacity declined 40 percent - far deeper than the reduction in defense, a far greater loss in capacity than that occurs in any but the worst wars (Ibid: 170).⁴² Only after an inevitable devaluation following the 1998 crisis, the import substitution effects began to come back, as domestic industries finally became more competitive against imports and production began to pickup.

Doctor #3: The United States/ the US Treasury

⁴¹ Refer to Appendix VI

⁴² Refer to Appendix VI

The Soviet Union was a threat like no other to the United States. The Soviets were not only a nuclear superpower but presented an alternative political and economic system. The Soviets openly spread the communist ideology over the world that was anti-Western and anti-capitalist (Gorbachev 2000). The United States, of course, reciprocated the enmity toward the Soviet Union. During the World War II, then-senator of Missouri, Harry S. Truman stated, “If we see that Germany is winning the war, we ought to help Russia, and if Russia is winning we ought to help Germany and that way let them kill as many as possible” (Sakwa 2008: 341). And, during the Cold War, Richard Pipes, who had been responsible for incurring economic damage to the Nazis during the World War II, first recommended to the American administration to use a similar economic tactic to cripple the Soviet economy.⁴³ (Gaidar 2010: 107). But even he confessed that the Soviet dissolution was unexpected (Aron 2011).

In the late 1980s when the Soviet collapse became an imminent possibility, the West actually tried to preserve the Soviet Union fearing the nuclear proliferation and political instability in the region (Sakwa 2008: 32). Even when Yeltsin, the “Westernizer” as the Russian media referred to him, was ascending in power, the West was skeptical of this iconoclast and preferred to deal with a committed Leninist, Gorbachev (Ronsenthal 1991). The Bush administration supported Gorbachev until October 1991, and only belatedly and reluctantly switched its allegiance to Yeltsin. Once the Russian Federation became independent, Strobe Talbott was appointed to handle diplomatic and security issues, while economic consulting was handled by Larry Summers and David Lipton at the US Treasury (Rutland and Dubinsky 2008: 4).

⁴³ In 1982, Reagan passed a directive on national security (NSDT-66) that set damaging the Soviet economy as its goal (Gaidar 2010: 107).

However, while the US intervened in Germany, Italy and Japan with military force to impose democracy after the Second World War, no such imposition was made in Russia (Payne 2006).

As to economic assistance, the US provided food aid through the United States Agency for International Development (USAID) and economic consultancy through the US Treasury. The US and the IMF shared in their support for Shock Therapy 2.0 (Stiglitz 2002). They maintained that political reforms could wait as creating the market economy in Russia was of first significance (Aslund 2007a). The proponents of the Shock Therapy maintained, “Once depoliticization is accomplished, the secondary goal of establishing effective corporate governance can be addressed” (Boycko, Shleifer and Vishny 1995: 65). Nonetheless, there were critics that claimed, “In privatization, establishing effective ownership and corporate governance is primary objective, rather than on simply transferring nominal ownership to the private sector” (Kornai 1990 as cited in Lipton and Sachs 1990: 297). But ultimately, the shock therapists triumphed within the US Treasury Department.

Economic assistance came but was insufficient. In post-war Europe, the Marshall Plan – consisting of \$13 billion in aid to Western Europe between 1948 to 1951 - was a decisive factor in successful rebuilding of a region devastated by war (“The Marshall Plan”).⁴⁴ Today, it is widely lauded as the most successful economic assistance program (De Long and Eichengreen 1991). Based on this case, it can be assumed that the US clearly knew how to help and was capable of providing decisive help, but for Russia, it chose to do just the minimal instead. By 2001 (almost 10 years

⁴⁴ US Inflation-adjusted value of \$13 billion from 1948 is equivalent to \$128 billion in 2014. (Based on calculations at <http://www.usinflationcalculator.com>).

after the start of reforms) the US had sent only about \$1 billion in aid, and two-thirds of that was spent on nuclear-weapon related programs, managed by the Pentagon and the Department of Energy (Rutland and Dubinsky 2008: 4).⁴⁵ Conclusively, despite profuse academic literature demonstrating that foreign assistance was correlated with economic growth, not enough was done on the economic end (Easterly 2003; Dalgaard, Hansen and Tarp 2004). Aslund (2011: par 14) regretted it as a “sin of omission.”

From another perspective, though, the US could have done more damage to Russia but it fortunately did not. An observation made by Noam Chomsky, accomplished political commentator, comes to mind: “Through history, there has been no correlation between the internal freedom of a society and its violence and aggression abroad... The United States is the most open and freest society in the world, and it also has the most brutal record of violence and aggression in the world” (“Superpower Confrontation: Fear and Reality in the Arms Race” 1985). There was an obvious conflict of interest in that the US had no interest in reviving its own arch-nemesis. And, Russia, unlike Germany or Japan after the Second World War, never was willing to trade its foreign policy autonomy for prosperity and security within an increasingly integrated community of nations whose priorities are economic rather than political (Mankoff 2009: 21-22).⁴⁶

Nevertheless, the West’s assistance, though insufficient, served to at least partially alleviate the Russians in turmoil. For example, in 1998, after the financial

⁴⁵ USAID program ceased its operation in 2012 but between 1999 and 2012 the assistance amounted to less than \$200 million with a similar usage breakdown (20 Years of USAID Economic Growth Assistance in Europe and Eurasia 2013).

⁴⁶ Perhaps, the only possible exception was Andrey Kozyrev, who served as the Minister of Foreign Affairs of the Russian Federation between 1991 and 1996. He is widely considered the Atlantist whose policies were aimed at pivoting to the West but his policies would grow highly unpopular in Russia (Mankoff 2009).

crash, the US and EU announced food aid packages valued at over US\$1.5 billion for the Russian Federation (US contribution totaled \$ 409 million which was larger than the \$342.4 million US food aid to the continent of Africa in 2000) (Sedik, Sotnikov and Wiesmann 2003: par 1). But I consider that arguably more significant than the US food aid was the Clinton Administration's role in pressuring the IMF and the World Bank, who were unwilling at first to provide loans to a corrupt country like Russia (Stiglitz 2002: 80, 166). Condoleezza Rice (2000) recalled that due to coinciding political interests (preserving Russia from communist retrenchment), US support for democracy and the Shock Therapy in Russia soon became synonymous to unconditional support for West-friendly Yeltsin and his agenda, despite the growing awareness of his reforms that had turned away. Yeltsin received consistent support from the leaders of the Western democracies (e.g. Bill Clinton, Helmut Kohl, Francois Mitterand), which eventually disgruntled the Russian hard-line parliament (Dunlop 1993: 310).

Doctor #4: The Russian Federation

Apart from all external groups, Russia's future lay precariously in the hands of Yeltsin's administration. Despite the lackadaisical support from the West, had Yeltsin's administration been less polarized and more commanding over the country, reforms could have been far more successful. Again, this argument enforces the notion that Russia's most pressing needs were political reforms, not economic. Unless political reforms could establish political consensus and stability, economic reforms were doomed for failure. Essentially, the greatest testament to the fact that political reforms were more pressing than economic was the constitutional crisis in 1993 that not only obstructed economic reforms but almost destabilized the country like in 1917. Going

back to the metaphor, the lesson was that without a clear consensus among doctors no successful surgery would be made.

In November of 1991, Yeltsin appointed Yegor Gaidar as the deputy prime minister to spearhead the Shock Therapy.⁴⁷ Yeltsin's decision was hardly surprising because Gaidar and Yeltsin had shared beliefs in radical reforms, in contrast to Gorbachev's beliefs in gradual reforms. Bringing young reformers was expedient not only because the *Nomenklatura*, bureaucrats of the old regime, were incompetent to lead market economic reforms, but because most of them were unwilling to risk their images being tarnished (Sackur 2008). Although with no background in politics,⁴⁸ Gaidar was by far the most qualified young economist coming of the Soviet Union with good understanding of the market economy. Furthermore, his reforms were endorsed by the IMF, the US Treasury and western advisers, who promised assistance under the agreement of meeting certain conditions (Serge 1992). Together with his team consisting of 35 to 40 year-old reformists that had worked with him in the Institute of Economic Policy and external groups, Gaidar would work day-and-night applying the Shock Therapy until his premature exit from office 13 months later. Today, he is considered the father of Russia's modern market economy.⁴⁹

⁴⁷ "Five teams were headed, respectively, by Grigory Yavlinsky (liberal but supported the maintenance of the Soviet Union), Yegor Gaidar (consistent market liberal and for Russia's independence), Yevgeny Saburov (liberal but cautious), Yuri Skokov (illiberal), and Oleg Lobov (illiberal)" (McFaul 2001: 142; Aslund 2007: 90).

⁴⁸ "Gaidar's political position was always exceptionally weak. Appointed deputy prime minister in charge of economic policy on 7 November 1991, he became first deputy prime minister on 2 March 1992, acting prime minister on 15 June 1992, and was dismissed on 14 December 1992 (returning briefly to the economics portfolio in late 1993)" (Sakwa 2008: 292).

⁴⁹ Even though, for the public, Gaidar's name has become forever registered with disaster, many public servants and academics laud his efforts. Konstantin Sonin (2009), a prominent Russia economist, stated, "Gaidar proved to be correct: Two weeks after his price-liberalization policy went into effect, Russians once again saw food and basic consumer goods in the shops after years of being absent." Anatoly Chubais, the minister of privatization in the early 1990s, stated, "It was Russia's huge good fortune that in

Yeltsin, however, underestimated what his opponents could do. Although peaceful dissolution minimized loss of lives, it also allowed opponents to coalesce against him. Among them, two most influential individuals were Vice President Aleksandr Rutskoi and the Congress Chairman Khasbulatov. They disagreed with Yeltsin on two fronts. First, their disagreement concerned Gaidar's Shock Therapy, preferring the state-controlled transition to the market (McFaul 2001: 164). Their criticisms quickly garnered the support of the *Nomenklatura* (political organizations and interest groups) that were privileged under the Soviet system and were reluctant of change that the Shock Therapy was going to bring. Second, their disagreement concerned dictatorship versus democracy. In not so distant past, they argued, Gorbachev mistakenly experimented with democracy while pursuing economic reforms and Russia needed authoritarianism that would insulate the government from societal pressures until the market reforms were implemented (McFaul 2001: 167).

With strong opposition and interest factions, Russia was in an intractable circumstance and became practically ungovernable (Reddaway 1993: 32 as cited in Dunlop 1993: 297). Russia was *de jure* a parliamentary republic but *de facto* a presidential republic (Sakwa 2008: 46). The balance of power between the executive and legislative branches remained a power struggle rather than a clearly delineated matter settled by the constitution. Increasingly the parliament grew in strength and was able to block the executive branch's initiatives for constitutional amendments and radical economic reforms. For example, under pressure from the parliament, Yeltsin was forced to dismiss his prime minister, Gaidar, and replace him with a conservative Viktor

one of the worst moments in its history it had Yegor Gaidar. In the early 1990s he saved the country from famine, civil war and disintegration..." (Denisov 2009).

Chernomyrdin. Much like Gorbachev, as the time passed, Yeltsin was unable to create broad political and social base for his support. In effect, Yeltsin's political reforms were reduced to similar results as Gorbachev's political reforms: polarization, confrontation, and eventually armed conflict (McFaul 2001: 198). The Russian case seriously undermined Przeworski's (1991: 11-12) postulation that uncertainty coupled with equally strong parties create a condition conducive of democracy, but in Russia competition bred conflicts instead. The lesson learned was that uncertain distributions were not guarantors of successful transition. It also became clear that imposed transition under autocratic regime can easily spiral down to an illiberal democracy or even a pseudo-democracy (Rueschemeyer, Huber and Stephens 1992: 20).

Because no constitution clearly delineated the boundaries between the executive and legislative branches, the power struggle in Russia soon escalated to a 1993 constitutional crisis that nearly escalated to another civil war (Dunlop 1993; Sakwa 2010). The crisis lasted from September 21 to October 4 (14 days). Referring to the clash, Yevgeny Fateev (1993 as cited in Dunlop 1993: 310), a television journalist, stated, "Today, our country was on the edge of the abyss, on the edge of anarchy, and perhaps, even on the verge of a civil war." The disagreements were both political and economic. While Yeltsin was determined to continue with the Shock Therapy based on the favorable results of the 25 April 1993 Referendum,⁵⁰ the stubborn parliament disagreed and impeached Yeltsin, proclaiming vice president Alexander Rutskoi to be the acting president. In fact, Yeltsin was temporarily abandoned by heads of the Russian Defense Ministry, Ministry of State Security, and MVD (Ministry of Internal Affairs), who sided with the Parliament against him (Dunlop 1993: 297).

⁵⁰ Refer to Appendix V

Two constituencies proved decisive to Yeltsin's victory. Taylor (2003: 283) observed that in the constitutional crisis of September 1993, the armed forces became the arbiters and helped Yeltsin win. Taylor asserted that Rutskoi's key blunder was ordering the army to storm Ostankino, the television station, and the Mayor's office as the army would have had to go against peacefully demonstrating people (Ibid: 299). With 87 people killed and 437 wounded, the clash marked the single-most deadly event of street fighting in Moscow's history (Winters and Litovkin 2013).⁵¹ Another Yeltsin's faithful constituency was the public both in August 1991 and again in September 1993. According to a poll taken by All-Russian Center for the Study of Public Opinion (VTsIOM) in September 24-28, 1993, 44 percent of population was supporting the president and the government, 15 percent was in favor of the Supreme Soviet, 32 percent was supporting neither group and 9 percent was unable to answer (Dunlop 1993: 317-318).⁵²

Undoubtedly, the task was daunting but it was a non-negotiable for the success of Russia's transformation. Yeltsin either had to win the hearts or defeat the competing factions - the powerful military-industrial complex (e.g. large energy companies), the military, the KGB (security agency) and regional governments - in order to maintain power and govern the country properly (Dunlop 1993; Mankoff 2009: 56). The greatest threat, however, lay within the *trias politica*. Yeltsin's Russia was essentially a "Dual State" with the president and the parliament sharing vested powers due to the distinctive nature of the Soviet dissolution (Sakwa 2010). No constitution clearly delineated the

⁵¹ Non-governmental sources claim that the death toll was as high as 2,000

⁵² In the city of Moscow, where the crisis was actually unfolding, fifty-seven percent supported Yeltsin, fifteen percent the Supreme Soviet, twenty-four percent supported neither, and four percent were unable to answer (Kuranty, 1 Oct 1993, 1 as cited in Dunlop 1993: 318).

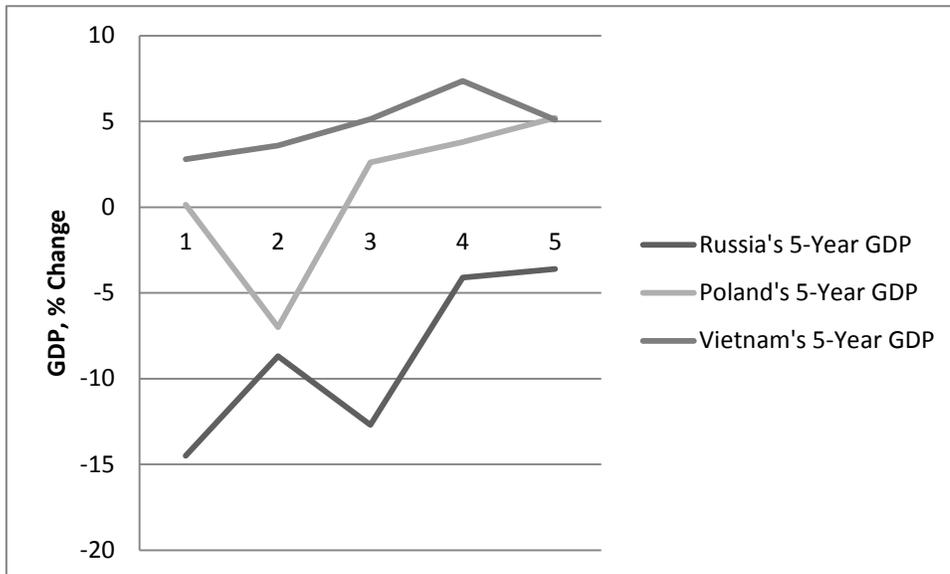
boundaries of each other's authority. The postponement on political reforms proved to be a mistake when the power struggle culminated in a 1993 constitutional crisis that nearly escalated to another civil war (Dunlop 1993; Sakwa 2010).

Politics that undermined economics

Popov (2000) contended that the reform debate between the shock therapists and gradualists was misfocused on speed since both Gorbachev's 1985-91 gradualist reforms and Yeltsin's 1991-92 radical reforms failed due to weak institutions, not speed. Certainly, emphasis on institution-building was part of the debate from the start. However, Popov's contribution was a suggestion that gradualist or shock therapist policies could be used interchangeably depending on which path for the given circumstance contributed to strong institution-building.

In addition, he presented examples of Vietnam and China as two countries that shared many similar initial conditions and achieved same results by taking two different strategies: the former pursued the Shock Therapy and China chose a classical gradualist path. Taking into account Sach's timeframe of five years system transformation of economies, I have compared three countries in their GDP performance in Figure 12. While Polish and Vietnamese economies demonstrated economic growth, Russia was not able to turn the corner.

Figure 12: Comparison of Russia, Poland and Vietnam's 5-Year GDP Change During Radical Reforms



Source: Retrieved from the USDA 2013; data from the World Bank World Development Indicators, International Financial Statistics of the IMF; Annual GDP for Russia is from 1992-96; for Poland, it is 1990-94; for Vietnam, 1986-90

While many explanations could be made, Popov (2000: 29) emphasized that the reforms differed vastly in outcomes according to incumbent political regimes. He gave an example of fiscal policies:

- Under strong authoritarian regimes such as China, government spending cuts occurred at the expense of military spending, subsidies and government investments but expenditure for “ordinary government” as a percentage of GDP remained largely unchanged (Naughton 1997 as cited in Popov 2000: 29).
- Under strong democratic regimes such as Poland, expenditure for “ordinary government” declined only in the pre-transition period but increased during transition.
- Under weak democratic regimes such as Russia, however, reduced government spending led to decline in military spending, subsidies and investment as well as expenditures for “ordinary government.”

I agree with Popov’s argument that the reform debate took a wrong focus on reform speed. The success of Shock Therapy hinged more on the strength of institutions. Political stability and the rule of law are decisive to the success of transitions (USAID and MSI 2002: 118-19).

It is no secret that economic policies are almost always highly dependent on the political environment and decision-making. And despite myriads of hard-pressing problems, doctors should have first put the hospital in order. Yeltsin reflected in his memoir about the constitutional crisis and his policies,

Maybe I was in fact mistaken in choosing an attack on the economic front as the chief direction, leaving government reorganization to perpetual compromises and political games. I did not disperse the Congress. . . . Out of inertia, I continued to perceive the Supreme Soviet as a legislative body that was developing the legal basis for reform. I did not note that the very *Congress* was being co-opted... but the painful measures proposed by Gaidar, as I saw it, required calm—not new social upheavals. Meanwhile, without political backup, Gaidar’s reforms were left hanging in midair. (1994: 127)

Yeltsin mistakenly assumed that dissolving the Soviet Union and achieving independence of Russia was sufficient on the political end to generate a political consensus and stability. Of course he understood that the Russian democracy would be a work in progress, but he did not expect to be constrained by a weak democracy as much as Gorbachev was in his final years by the weak Soviet regime.

Even shock therapists admitted to failures on democratic consolidation. They spoke of the constitutional crisis and following establishment of the super-presidentialism⁵³ that undermined Russia’s democratic consolidation. (Aslund 2007b: xiv). Taking example of elections, Rose-Ackerman (1999) observed that while elections increased accountability of politicians, they also generated new incentives for corruption as political financing needs increased. Gaidar (2000: par 51) recalled that the loans-for-share was a president’s maneuver to amass political support that he had lost in order to establish new order and stability: “If I understand correctly, the deals concerning the

⁵³ The need for separation of powers or checks and balances and many other crucial mechanisms were simply discarded which led to disproportionate power vested in the executive branch (McFaul 2001: 311).

loans-for-shares were first and foremost directed at creating a critical mass of influential and powerful political forces, which were vitally interested in preventing the return of the Communist regime.” Treisman (2000) rightfully observed that democracies become significantly less corrupt only after 40 years as institutions become recognized and adhered to by the societies and governments. Russia’s democracy was more accurately O’Donnell’s (1994) “delegative democracy”⁵⁴ or Zakaria’s (1997) “illiberal democracy.”⁵⁵ In other words, Russia was a democracy more by name. Curiously, however, they avoided discussing the effect of the constitutional crisis of 1993 on the Shock Therapy when it is clear that Yeltsin’s failure to dissolve the parliament early on had equally significant political as well as economic implications.

Russia’s Future

With Putin’s rise to power in 2000, the uncertainties of power politics began to subside precipitously as he began strengthening the power vertical and rebuilding an authoritarian regime.⁵⁶ In 2006, Vladislav Surkov (2006): par 6), an architect of the current Russian political system, began championing the popular slogan, “sovereign democracy,” which referred to

A society’s political life where the political powers, their authorities and decisions are decided and controlled by a diverse Russian nation for the purpose of reaching material welfare, freedom and fairness by all citizens, social groups and nationalities, by the people that formed it.

Essentially, the ‘sovereign democracy’ became a propaganda aimed at restoring

⁵⁴ “Whoever wins election to the presidency is thereby entitled to govern as he or she sees fit, constrained only by the hard facts of existing power relations and by a constitutionally limited term of office” (Rueschemeyer, Huber and Stephens 1992: 311).

⁵⁵ “Democratically elected regimes, often ones that have been reelected or reaffirmed through referenda, are routinely ignoring constitutional limits on their power and depriving their citizens of basic rights and freedoms” (Zakaria 1997: par 1).

⁵⁶ Kremlin tightened its position by reining in the media (e.g. closing down Rosbalt) and imposing a 150-fold increase in illegal protest fines (“Russia Approves 150-fold Rise in Fines for Illegal Protests” 2012).

the authoritarian power domestically as well as the regional hegemon status internationally. Although Yeltsin's super-presidentialism left the president's seat with vested power, Putin did not inherit a country that was a monolith - large energy companies and the security service, including the military were still influential, independent factions (Mankoff 2009: 56). So during his tenure, Putin's press secretary, Dmitry Peskov, recalled, in order of urgency, the challenges that Mr. Putin faced in his first and second presidential terms addressed, "He brought Russia's oligarchs to heel. He reclaimed authority over the security services. He eliminated the popular election of governors. He wrested television back from private hands. He raised pensions and paid off Russia's foreign debt" (Barry 2013). He achieved this by sealing an alliance with regional powers and imbuing their power into a dominant party "United Russia" to control the parliament (Reuter 2010). He also reined in the military by appointing Anatoly Serdyukov, a former furniture salesman and tax inspector with no background in defense issues, as the defense minister (Mankoff 2009: 58). He jailed Mikhail Khodorkovsky, then the owner of YUKOS Oil, to send a clear message to the *Oligarchs* to stay out of politics and renationalized YUKOS Oil under Rosneft.⁵⁷ The renationalization of the energy sector served a dual purpose of foreign affairs lever and a cash cow for the government budget.⁵⁸

In addition, Putin sought to re-establish Russia's status as a regional hegemon and free it from economic dependence on the West. In some sense, Putin's policies were a direct reflection of Russia's disappointment with the West in the early 1990s - a resolve to take control of their country's fate and take it to new heights. Not

⁵⁷ Igor Sechin, the ex-KGB, is the CEO at Rosneft. He has long been a loyalist of Putin.

⁵⁸ He placed *siloviki* (ex-KGB officials) as the boards of major companies like Gazprom, Rosneft, and Transneft. Putin dissolved Mikhail Khodorkovsky's Yukos Oil and oversaw its takeover.

surprisingly, Putin (2010), disgruntled by criticisms of the West on Russia, stated, “Quit lecturing us on what democracy is.”⁵⁹ Vladislav Surkov rebutted the West’s criticisms stating,

You cannot say that all economies and all democracies look alike. In France there is one type of economy and democracy, in Germany another, and in England - a third kind. Plans taken out of books do not work in countries like Russia with its specific features. There is no Caucasus in other countries, either in Britain or the United States (Havan 2010).

In this context, Putin’s “sovereign democracy” follows the suit of Hugo Chavez’s “21st century socialism,” or Lee Kuan Yew’s “Asian values” (Dobson 2013).

Putin’s job ratings soared during his two terms of presidency from 2000 to 2008 when high oil prices brought consecutive years of economic growth after almost a decade long disappointment under the newly attained democracy and market economy (de Vogel 2013).⁶⁰ Also, his charismatic image and fearless foreign affairs has brought back confidence to Russians in their country. Clifford Gaddy (2013), Senior Fellow at the Brookings Institute, asserted that it is the ‘old middle class’ or the *Nomenklatura* that are Putin’s constituency. Russia’s government leaders have done little to restructure welfare transfers, meaning that overall, welfare expenditures have been high by West European standards, and the neediest in society have not been targeted (McFaul 2001: 325).

⁵⁹ Dmitry Medvedev: “I strongly oppose those who think that there is no democracy in Russia and that authoritarian tendencies prevail here. It is not so. Russia is undoubtedly a democracy. It is young, it is immature, it is imperfect, not experienced, but it is a democracy nonetheless.” (Recknagel 2010: par 3) Christopher Walker (Freedom House): “The leadership doesn’t feel comfortable simply saying that they are developing a new form of authoritarianism. They are very careful both for their domestic and international audiences to arrogate the term democracy for their own purposes. So, the battle is really over how the term democracy is interpreted” (Ibid: par 17)

⁶⁰ A 2013 survey (N=1603) conducted by the Levada Center seemed to underscore this limitation: 37 percent of Russians opted for a state with a unique system and its own path of development, and only 28 percent opted for a state as in West with a democratic system and market economy. For more information refer to Appendix VII-IX.

Nonetheless, since the dissolution of the Soviet Union, Russia has made little progress on democratic consolidation. Yeltsin's established super-presidentialism and Putin's established parliamentarism have been enduring and will continue to have lasting impact on Russian politics in the future. Sakwa (2008) believes it is too early to rule out Russia's democratic consolidation. Pipes (2006) insists on Russia's cultural predisposition toward authoritarian form - the only alternative to keeping its vast territory in check and unity. McFaul (2001) disagrees arguing that Russia has been far too educated and too pluralistic to remain authoritarian. He notes,

Pluralist institutions of interest intermediation are weak, mass-based interest groups are marginal, and institutions that could help to redress this imbalance – such as a strong parliament, a robust party system, and an independent judiciary – have not consolidated. In addition, a deeper attribute of democratic stability – a normative commitment to the democratic process by both the elite and society – is not apparent in Russia (Ibid: 4)

For example, the “two turnover” rule of electoral procedure, which many scholars state as the key determinant for the consolidation of democracy, was indefinitely delayed in Yeltsin's handpicked succession of power to Putin and later in Putin's amendment of the constitution to run for the third time as the president⁶¹ (Ibid: 25). Yeltsin himself admitted in his resignation speech of 1999 that his premature exit and appointment of his successor would mean that Russia would not see one democratically elected leader

⁶¹ Direct elections of regional governors were held from 1996 to 2004 until Putin abolished them; then in 2012 Medvedev pushed a law to reinstate them through the Parliament in response to growing political opposition until Putin signed a law in 2013 allowing regions to cancel governor polls (Kremer and Kaznin 2013). These challenges have been a test to Putin's power. If democracy in Russia is indeed 100 years in the making as Medvedev commented once, power-monopolized Kremlin will have to grant more autonomy to its regions (regional parliaments and the Federation Council), all the while containing the Pandora box of centrifugal forces (Ordeshook and Shvetsova 1995; "Medvedev Says Russia's Democracy Needs 100 Years to Develop.").

transfer power to another as established in the constitution (Sakwa 2007: 24).⁶² Much like Yeltsin transferred power to Putin, Putin colluded with Dmitry Medvedev to form a duopoly. Most decisively, Putin's amendment of the constitution and third presidential election in 2012 marked a sharp turn away from the democracy.

In addition to political uncertainties, however, the country is still plagued by structural economic problems: low labor productivity; poor infrastructure; excessive regulations; energy inefficiency; high public spending, especially on pensions; heavy dependence on commodities, especially oil and gas; and widespread corruption and weak rule of law (Åslund et al. 2010; Treisman 2000). Frye (2010) stated that based on enterprise surveys from 2000 and 2008 corruption has not abated after 2000 but become worse. Guriev and Zhuravskaya (2010) maintain that if Russia is to break out of the resource curse trap, political and economic reforms must be implemented, including: further privatization; deregulation of business; macroeconomic stabilization and disinflation; membership in the World Trade Organization⁶³; reform of the judiciary, education, healthcare, and pension system; and reform of natural monopolies. Stiglitz (2002) maintains that with its abundant endowments, if Russia pulls itself together, similarly to China, it can achieve great economic growth.

⁶² Gorbachev described Putin's governing party, United Russia, as "a bad copy of the Soviet Communist Party" (Levy 2010). In that sense, Gorbachev did great service to Russia by not clinging to power or appointing a successor (Shevtsova 2011).

⁶³ This objective, at least, was achieved in 2012

Conclusion

The Shock Therapy has certainly succeeded in preventing Russia from a complete collapse and a communist retrenchment. In place of communism, Russians could have erected fascist, imperialist, or neo-communist regimes but they have not done so (McFaul 1999). And, despite heavy costs, rudiments of a market economy were established through the Shock Therapy. Although these may have been plausible goals for some developing, post-colonial countries, I found these goals entirely unacceptable for a country that once boasted the third largest economy and shared the superpower status with the US. And more importantly, I have maintained that the Shock Therapy ought to be assessed by its original promises: establishing of preconditions for economic growth and democratic consolidation (Aslund 2007; Stiglitz 2002; Sachs 2000; Friedman 2000). In this view, the Shock Therapy in Russia failed. As discussed in this chapter, the primary reasons for failure were insufficient and incompetent assistance by external groups and lack of internal political consensus and control. And, the early legacies of Yeltsin have greatly undermined political and economic progress in Russia that is evident even to this day.

Chapter 4: The Other Cases

A Comparative Study of Other Countries

Introduction

Although the post-Soviet transformation of Russia has been like no other case before due to the scale and speed of reforms, the discussion can be enriched by drawing some comparisons with previous reforms in other countries. Although any comparative study runs into obvious problems (e.g. differences in context, culture, people, time), Russia's Shock Therapy was a direct imitation of Poland's Shock Therapy. Both gradualists and shock therapists have drawn numerous comparisons with Latin American cases, Polish case, and Chinese case. In this brief chapter, I will draw some lessons from previous reforms, gradualist reforms and shock therapy, in an effort to understand better why Russia's shock therapy failed.

Case #1: The Latin American cases

When considering the Shock Therapy, the Latin America cannot be omitted in the discourse since it was first implemented in these countries. Some scholars have committed the mistakes of directly transposing the Latin American experiences to Russia but admittedly, there were certainly valuable lessons that Russia could learn from the past (McFaul 2001). Samuel P. Huntington (1991) went as far as to bundle them together as the "third wave of democracy." But the Soviet collapse was quite different from Latin American autocratic regimes: 74 years of centralized planning not only distorted the supply-demand relationship in the economy but was far-reaching to political and social spheres. There are largely two lessons to be drawn from the other patients in Latin America. First, scholars learned a great deal about how authoritarian

regimes make transition to democracies. Second, scholars learned that the Shock Therapy can be implemented successfully both in autocracies and democracies.

First, several scholars of Latin American transition have widened the collective understanding of transitions from authoritarian regimes to democracies. The fall of authoritarian regime is initiated by a split within an authoritarian regime between soft-liners (liberal) and hard-liners (conservative). Once the soft-liners gain the upper hand, they implement political liberalizations, which are met with favor by moderate societal actors and with opposition from radical societal actors. Democracy is made possible only when the soft-liners and moderates succeed in isolating the hard-liners and radicals from power and consolidate democratic reforms (O'Donnell and Schmitter 1986).

In Russia, this struggle was observed most vividly in August 1991 and in September 1993.⁶⁴ The hard-liners were conservatives that favored their status quo and communism. They were consistently against gradual reforms (*Perestroika* in 1991) and radical reforms (the Shock Therapy in 1993) alike. The August 1991 coup attempt by the communist hard-liners against Gorbachev's *Perestroika* marked the first occasion. In the midst of struggle between the hard-liners and Gorbachev, in June 1990, a soft-liner, Yeltsin with the help of the moderate societal actors ascended to power, declared the RSFSR sovereign and in December 1991, succeeded in establishing an independent Russian Federation. The September 1993 coup attempt by the communist hard-liners from the parliament against Yeltsin's Shock Therapy marked the second occasion. Yeltsin defeated the communist hard-liners from bringing back communism largely by the help of the moderate societal actors once again.

⁶⁴ For more information on the August 1991 coup, refer to Chapter 1: Yeltsin and Reformation of Power. For more information on the September 1993 coup, refer to Chapter 3: Doctor #3

Second, the Latin American experience proved that the Shock Therapy can be implemented successfully both in autocracies and democracies. Most Latin American countries were plagued by large budget deficits and public debts resulting from excessive government spending and highly inefficient government enterprises; lagging private enterprises due to overly protectionist measures; and hyperinflation due to loose monetary policies (Sachs 2000). Many of these symptoms were evident in Russia as well. While theoretically import substitution policies were sound, Latin American countries began generating windfall profits from oil exports. As credit ratings went up, foreign banks began lending large sums of money and many Latin American countries borrowed to the point where they could no longer service debt payments. And untimely commodity price drops in the 1980s exacerbated problems. Debt crisis led to hyperinflation as the governments printed more currency to finance their budget deficit instead of cutting budgets (de Lozada 2001).⁶⁵

At the time, the general sentiment was that hyperinflation could not be treated in a democracy. It was thought that people would rise against radical measures. Therefore, only autocracies like Pinochet's Chile were thought capable of suppressing civil liberties and imposing the Shock Therapy. Authoritarianism was viewed as a necessary evil to economic growth and democratization. Friedman (2000: par 76) proudly spoke about the Miracle in Chile,

Chilean economy did very well, but more important, in the end the central government, the military junta, was replaced by a democratic society. So the really important thing about the Chilean business is that free markets did work their way in bringing about a free society.

⁶⁵ Chile experienced highest inflation of 746.30 percent in April of 1974; Bolivia 23,464.36 percent in September of 1985. Russia's hyperinflation peaked at 2,500 percent in its first year. For more information refer to Inflation Rate (tradingeconomics.com)

Yet, the Bolivian case shattered this misconception. It became the first country to treat hyperinflation in a democracy without depriving people of their civil rights and without violating human rights like Pinochet (de Lozada 2001).

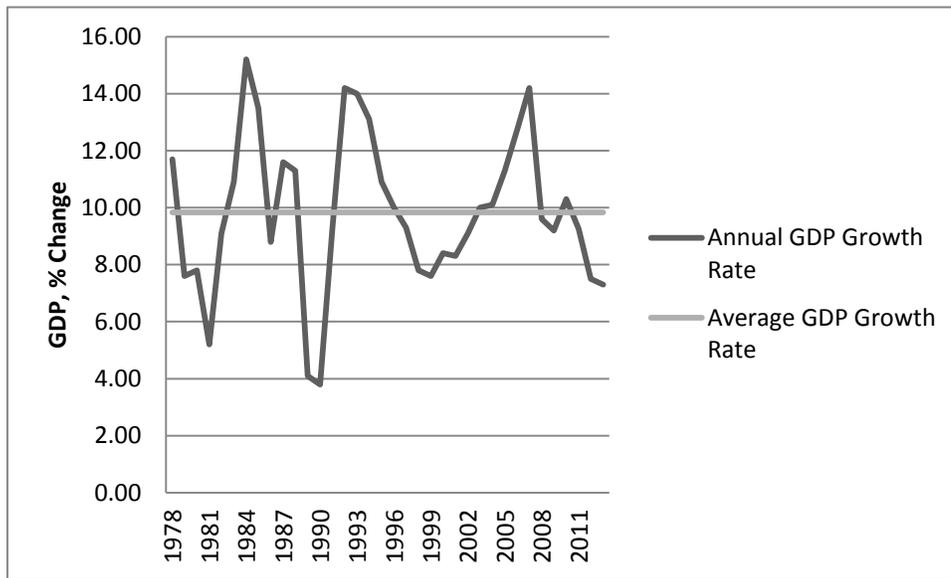
Nevertheless, several decades later, it is difficult to argue that the Shock Therapy has brought sustained economic growth or democratic consolidation to Latin American countries. The common side-effect of Shock Therapy in Russia and in Latin America alike has been the weakened legal institutions as the *trias politica* became tilted excessively to executive over the legislative or judicial branches. On a long term, this has served to de-legitimize state power, erode democratic basis of the state, and undermine fiscal capacities of the state (Orenstein 1998). That is, Shock Therapy seems either to have pushed weak democracies to authoritarian regimes or de-legitimized authoritarian regimes without supplanting them with strong institutions.

Case #2: The Chinese case

Relative to the Latin American cases, Russia's transition drew much wider comparisons with Poland and China. The success of Russian reforms was to be gauged relative to these alternatives. China took a path of gradual reforms instead of the Shock Therapy and in past three decades, has achieved one of world's biggest booms. As evident in Figure 3, since the Deng Xiaoping's reforms in 1978, China experienced an average GDP growth of 9.8 percent annually and its 2013 GDP has become 26 times of what it was in 1978 (World Bank Development Indicators, International Financial statistics of the IMF). In 1990 China's GDP was 60 percent that of Russia, but by the end of the decade numbers were reversed (Stiglitz 2002: 6). The "Four Modernizations" aimed at strengthening China in agriculture, industry, national defense, and science and

technology were at the core of Deng Xiaoping's reforms. China's reforms began in agriculture because at the time of reform, the country still remained largely agrarian and also because its officials were acutely aware of dangers in food shortages and famines, especially after the "Disaster of 1959" that killed millions of its people during the *Great Leap Forward*.⁶⁶

Figure 3: China's GDP Performance, 1978-2013



Source: Retrieved from the USDA 2013; data from the World Bank World Development Indicators, International Financial Statistics of the IMF.

One of most ingenious aspects of the gradual reforms in China was the dual-pricing systems where state-owned enterprise production quotas were sold at planned prices and any additional production at market prices (Ibid: 182-183). This method devised by Kenneth Arrow, Nobel prize-winning American economist, and the Chinese reformists solved the chronic shortages that plagued centrally planned economies and avoided heavy socioeconomic tolls of the Shock Therapy. Furthermore, it allowed full incentives for producers.

⁶⁶ Mao Zedong's 1958- 1961 campaigns aimed at rapid industrialization and collectivization, similar to Stalin's collectivization and industrialization in 1930s.

China demonstrated Schumpeter's (1987) "creative destruction" in which the old price system was gradually pushed out as new enterprises with market prices met consumer needs. Concurrently, this pace allowed for institutional infrastructure to be established. Sachs (1994), however, argued that the dual-pricing system could not work for the post-Soviet state because while the state sector employed only 18 percent in China, the Soviet Union had employed almost all the workers, whom it could not subsidize or protect any longer.

Sachs (Ibid: 285) maintained that the Chinese case was largely inadequate in comparison to the post-Soviet transition for three reasons. First, China did not face dire financial circumstances at the start of reforms and did not require contractionary fiscal or monetary policies. Second, politically speaking, China was much more decentralized than the Soviet Union with more independence on provincial and regional levels. Third, most importantly, at the start of reforms in 1978, more than 70 percent of China's population belonged in the peasant agricultural sector but only 12 percent of the Russian labor force was in agriculture at the start of Yeltsin's reforms. In other words, China's industrialization and urbanization was surging, while Russia had already become an overly-industrialized economy. Murrell (1993: 12) concurred that while post-war successes of West Germany and Japanese economies may speak to the possibilities of major economic reconstructions, China differed in its predominantly peasant agricultural economy, underdeveloped industrial sector, and vastly differing political context to post-Soviet Russia. Aslund (2007b: 5) went as far as to say,

Chinese agriculture could easily be reformed through the introduction of quasi-property rights for peasants, which was impossible in the Soviet Union. Soviet industry was too big and distorted to be omitted, but it was also too powerful to be reformed. The situation in China and the Soviet

Union differed in almost every political and economic regard. The problem was not that Gorbachev did not follow the Chinese lead but rather that he followed it too closely under very different preconditions.

Stiglitz (2002: 186) responded directly to the critics in defense of gradualism,

Poland is alleged to have had an advantage because it was more industrialized, China because it was less so. China, according to these critics, was still in the midst of industrialization and urbanization; Russia faced the more delicate task of reorienting an already industrialized but moribund economy. But one could argue just the converse: development is not easy, as the rarity of successes clearly demonstrates. If transition is difficult, and development is difficult, it is not obvious why doing both simultaneously should be easy. The difference between China's success and Russia's failure in reforming agriculture was, if anything, even greater than the two countries' success in reforming industry.

Nonetheless, the valuable lesson from the Chinese case (at least so far) was that as McFaul (2001: 10-11) stated, "... economic transformation can occur without political change in the post-communist state, but political change cannot take place without economic change occurring simultaneously." In 2014, three decades since Deng Xiaoping's reforms, China boasts the second largest economy today and is soon projected to become the first. Nevertheless, China has achieved economic growth at the cost of abandoning democratization. In early 1990s, Russia's adoption of democracy meant that economic and political transformation had to occur simultaneously – a daunting task that carries great risks and repercussions.

Case #3: The Polish case

If China has been arguably the most successful at gradualist reforms, Poland has been arguably the most successful East European country that transitioned to market economy via the Shock Therapy, and (Aslund 2007a; Stiglitz 2002). Poland similar to the Latin American countries struggled with hyperinflation but in addition to that, it also

faced typical structural problems of the socialist command economies. Therefore, it is more fitting to compare Russia to Poland (Gaidar 2000). Both Russia and Poland shared a past in a central planning, and the two reforms also took place just a couple years apart from each other (Poland in 1990 and Russia in 1992). The Polish case is significant in that the Shock Therapy enabled a post-Soviet country to achieve economic growth without hindering democratic consolidation.

Shock therapists have come to embrace Balcerowicz's reforms in Poland as the epitome of how the Shock Therapy ought to be implemented.⁶⁷ One of the shock therapists, Aslund (2007a: 88), argued that Poland's success was owed to the one big bang in January 1990 that consisted of four vital measures: "First, a far-reaching price liberalization; second, a truly radical external liberalization; third, the breaking up of state concerns and associations into single enterprises; fourth, and, possibly most important, a legal act allowing anybody to sell anything anytime in any place at any price to anybody."

Stiglitz disagreed arguing that Poland's success was a result of its partial deviation from the Shock Therapy doctrine,

Poland started with "Shock Therapy" to bring hyperinflation down to more moderate levels, and its initial and limited use Poland quickly realized that Shock Therapy was appropriate for bringing down hyperinflation, but was inappropriate for societal change. It pursued a gradualist policy of privatization, while simultaneously building up the basic institutions of a market economy, such as banks that actually lend, and a legal system that could enforce contracts and process bankruptcies fairly... (2002: 180-181)

⁶⁷ Curiously, Balcerowicz (1995: 342 as cited in Aslund 2007a: 42) concluded that the Polish "... economic reforms failed because they were not radical enough, that is, they did not reach a certain threshold of necessary changes rapidly."

Poland's former deputy premier and finance minister, Grzegorz W. Kolodko (1998), concurred with Stiglitz that had his country fully pursued the Shock Therapy, it would have ended up like Russia. To avoid such a tragedy, he maintained, Poland radically liberalized its domestic economy and achieved financial stabilization in accordance with the Shock Therapy. Yet, it controlled trade, privatized enterprises gradually, and paid salaries and pensions adjusted for inflation. Stiglitz (2002) especially commends Poland for caring for their people, the very building block of democracy, by prioritizing institutions-building and securing safety nets.

Others have contended that the success of economic reforms depended on politics. Balcerowicz (2000) asserted,

In Russia, for political reasons, reformers were not given the same amount of chance.⁶⁸ So only after half a year, there were disruptions in the economic program, especially on the fiscal side and on the monetary side. So the stabilization effort was not given a chance, and this is the main reason why Russia is less successful than Poland.

Sachs (1994: 284) concurred, "If one can draw any clear conclusions from Russia since 1991, it is that economic reform can work effectively, if politics gives the reforms time to take hold." With all else held constant, it is the nature of the state that determines whether democracy and development can occur simultaneously (Aydin 2005: 59). De Lozada (2001) asserted that Russia failed because there was no political will in Russia. In Poland, for example, there was a much higher degree of national consensus on the political and economic reforms than in Russia and this consensus had emerged long before the radical reforms in 1990 (Pereira 1993: 141 as cited in McFaul

⁶⁸ Balcerowicz was given 500 days to reform

2001: 12).⁶⁹ Although the specifics of which capitalism to adopt - the Scandinavian social welfare state, Thatcherism, the German social market - were left for later, its goal of joining the European community was overwhelming and unifying (Sachs 2012). And while Russia had not such a clear patron in the European Union (EU), Balcerowicz (2000) spoke about Russia's huge natural resources that became the "oil curse" as evidenced by the privatization process and the subsequent unstable politics.⁷⁰

The case of other patients has been valuable in the debate. The Latin American case demonstrated that Shock Therapy 1.0 is a functional tool in different political regimes: both in an autocracy or a democracy. It also elucidated how authoritarian regimes break apart politically. The Chinese case demonstrated that gradualist reforms under socialism can generate economic growth, though not democracy. Most importantly, the Polish case demonstrated that Shock Therapy can indeed transform a socialist system into a market economy without hindering democratic consolidation.

Gaidar decidedly followed the Polish Shock Therapy route, though reaped markedly different outcomes.⁷¹ On the other hand, Chinese gradualist route achieved unprecedented economic growth to become the second largest economy. Although scholars have engaged in heated debates concerning the applicability of other countries' reforms due to differences or similarities, the bottom line has been that Poland and

⁶⁹ Balcerowicz (2000) stated that the Polish Shock Therapy was 12 years in the making before actually being launched in 1990. Also, the hard-line Communists were discredited early on and democratic opposition did not quarrel, the political environment was made conducive to the Shock Therapy. Polish citizens were also more willing to bear the socioeconomic costs because these reforms marked freedom from the Soviet Union.

⁷⁰ For more information refer to Chapter 2, Pillar #1: Liberalization

⁷¹ Whether for good or for bad, Gaidar and Balcerowicz shared many similarities in that both of them were home-grown economists (though Balcerowicz received a Master's in Business Administration from St. John's University in the US). In fact, the favorite book of all leading neoliberal economic reformers - Leszek Balcerowicz (Polish implementer of the Shock Therapy), Yegor Gaidar, and Anatoly Chubais - was Friedrich Hayek's *The Road to Serfdom* (1944/1986) and *The Constitution of Liberty* (1960) (Aslund 2007: 234).

China have both succeeded in their respective reforms, while Russia has not. The pattern indicates that politics determines whether or not reforms are successful.⁷² Stalin was successful with his radical reforms, though at heavy costs and short-term gains, because of politics. Gorbachev's gradual reforms were unsuccessful because of politics. Yeltsin's radical reforms were unsuccessful because of politics. As stated earlier, since the Soviet collapse was a result of deliberate politics, political reforms were the most pressing medication.

Conclusion

In this chapter, I have drawn lessons from previous reforms, gradualist reforms and shock therapy alike, in an effort to understand better why Russia's shock therapy failed. Table 4 summarizes the lessons to be drawn from the comparative study.

Table 4: A Comparison of Chile's, Bolivia's, China's and Poland's Reforms

	Diagnosis	Reforms	Political Regimes	Political Repression	Political Consensus
Chile (Augusto Pinochet)	Hyperinflation, Budget deficits, foreign debt	Shock Therapy 1.0	Authoritarian	✓	✓
Bolivia (Gonzalo Sánchez de Lozada)	Hyperinflation, Budget deficits, foreign debt	Shock Therapy 1.0	Democratic	✗	✓
China (Deng Xiaoping)	Underdevelopment	Gradualist reforms	Authoritarian, Communist	✓	✓
Poland (Leszek Balcerowicz)	Endemic shortages and inefficiencies, budget deficit & foreign debt	Shock Therapy 1.0 & gradual privatization	Democratic	✗	✓

⁷² For more information, read Chapter 3, section "Politics that undermined economics."

While gradualists and shock therapists rushed into debate about the speed of reforms invoking different success cases or criticizing each others' arguments, I have maintained that it is not necessarily a contradiction that there are cases of success and failure for both gradualist reforms and the shock therapy. The common denominator has been the degree of political consensus or control over a country.

Political stability and the rule of law can be carried out by either strong democracies or authoritarian regimes but not in weak democracies or authoritarian regimes. Political consensus can be bypassed in strong authoritarian regimes. Such was the case for Stalin, who implemented his economic reforms and mercilessly crushed any opposition. Such was the case in Chile under autocrat Pinochet whose Shock Therapy was implemented quickly and comprehensively. Such was also the case in authoritarian China whose gradual reforms were implemented gradually and comprehensively. Political consensus proved essential for Poland and Bolivia. Poland's Shock Therapy succeeded largely because of political consensus: common incentive of joining the EU and commitment to institution-building (Mueller 2007; Popov 2000; Murrell 1993). Likewise, Bolivia, though a poor country then and even today, has proven that under strong democracy, its political consensus enabled it to implement the shock therapy 1.0 relative success. However, for weak democracies where repressive apparatuses are unthinkable, without political consensus, political or economic reform efforts, regardless of speed, have been consistently undermined (Frye 2010). For this reason, Gorbachev's 1985-91 gradualist reforms and Yeltsin's 1991-92 radical reforms have failed.

Epilogue

In this thesis, I have reconsidered the Shock Therapy that transformed Russia to what it is today. In hindsight, proponents, such as Anders Aslund (2007a, 2007b), have been more forgiving in their assessments claiming that radical reforms created a market economy, while the lack of clear political agenda inhibited democratic consolidation. On the other hand, gradualists, such as Joseph Stiglitz (2002), have been less forgiving claiming that the Shock Therapy created only crony capitalism, and one achievement, the creation of democracy with meaningful freedoms, remains fragile at best. I have withdrawn from the main debate centering around the speed of reforms because similar to Popov (2000), I observed that the success of reforms depended more on politics than economics; more on strength of institutions than the speed of reforms.

Proceeding with the medical metaphor, I have argued that the Shock Therapy failed due to misdiagnosis of the patient's sickness, misapplication of the medicine and the problems associated with the doctors. Firstly, the Soviet collapse was primarily of political nature, not economic, and hence political reforms were more urgent than the economic. Secondly, neoliberal Shock Therapy in Russia greatly undermined economic growth and democratic consolidation. Thirdly, external groups' insufficient and incompetent help as well as the lack of internal political consensus and control undermined the economic reforms.

1. *The Patient*. In this chapter, I have attempted to argue that the Soviet collapse was a deliberate political breakup by insiders (Gorbachev 2000; Aron 2011) and not an inevitable implosion due to economic or political contradictions (Gaidar 2010; Aslund 2007a, 2007b; Boettke 2002). This is not to overlook the fact that the Soviet Union with

its communist ideology and command economy was highly problematic. Rather, my aim has been to emphasize the fact that Gorbachev played a decisive role in triggering centrifugal forces, which Yeltsin took advantage of to deliberately dissolve the Soviet Union. The Soviet history showed clearly that it had overcome far more difficult political and economic crises in the past than in the late 1980s. And if indeed the Soviet collapse was a deliberate political breakup, its immediate remedy had to be firstly political reforms. Even though politics and economics were closely intertwined in socialism, politics always held the upper hand. Yet, shock therapists mistakenly diagnosed the illness and subsequently pursued firstly economic reforms.

2. *The Medicine.* The medicine administered in Russia was Shock Therapy 2.0 and differed largely from the Latin American cases in its neoliberal tendencies, especially in privatization. Granted that economic urgencies left Russia with no option but to pursue liberalization and financial stabilization, the corrupt, large-scale loans-for-shares program greatly undermined the Shock Therapy efforts in Russia. Instead of achieving economic growth, the economy double-dipped into a crisis in 1998 and instead of democratic consolidation, a newly-created class of *Oligarchs* sided with the Russian Government alienating the rest of its citizens from polity.

3. *The Doctors.* Nascent Russia's future was in the hands of four groups of reformers: independent foreign advisers, the IMF, the US Treasury Department, and most importantly Yeltsin's administration (Aslund 2007a). Although much can be blamed on external entities, it was ultimately the lack of internal political consensus and control that undermined the economic reforms the most.

Nelson Mandela famously stated, “We do not want freedom without bread, nor do we want bread without freedom. We must provide for all the fundamental rights and freedoms associated with a democratic society (Investiture as Doctor of Laws, Soochow University, Taiwan, 1 August 1993).” Putin (2005) stated similarly in the Annual Address to the Federal Assembly, “It is my firm belief that for present-day Russia democratic values are no less important than economic success or people’s social welfare.” Freedom and bread have represented hopes in the Russian revolution of 1991. The Shock Therapy promised bread (preconditions for economic growth) and freedom (democratic consolidation through creation of private property owners and liberalization of the markets).

In this thesis, I have demonstrated how the Shock Therapy brought more “Shock” than “Therapy.” First, the Shock Therapy as an economic reform policy did not create a precondition for promised economic growth within six months or three years or five years but a precondition for decline. Capital flights and corruption, high unemployment and wiping of savings, drops in outputs and income were not compensated by sufficient economic growth. After 7 years of prolonged recession, Russians would be hit by yet another recession, the crisis in 1998, and only after devaluation and rise in oil prices would economy begin to recover. Hence, even solely from an economic perspective, it failed to deliver economic growth within the given timeframe.

My contribution to the debate has been the elaboration on Popov’s (2000) argument that the debate was misfocused on speed of reforms instead of strength of institutions. While the importance of institutions may not have been new to the debate,

shock therapists and gradualists emphasized specific factors that generated exceptions to the opponent's success cases. Meanwhile, Popov has chosen to recognize that the Shock Therapy and gradualist reforms could both work as long as the reforms contributed to strengthening of institutions. I have interpreted the "strength of institutions" through political consensus and control in strong authoritarian regimes and democracies. And, I contended that Yeltsin's democracy that lack political consensus and control undermined the Shock Therapy.

I have also attempted to broaden the scope of discussion from being merely economic to include political as well. I have borrowed the "liberal approach" in the assessment of the Shock Therapy, using their success criteria of economic growth and democratic consolidation. Admittedly, in reality, the Shock Therapy had no direct agenda or concrete time table on democratization. Democratic consolidation was simply an implicit cause-and-effect theory related to economic growth. This conceptual blurring has allowed them to hide from taking blame on democratic failures and to take credit for democratic successes. Nevertheless, the Shock Therapy entailed political interest groups and long-term political implications. I have attempted to criticize the convenient, one-sided conceptualization of the Shock Therapy and brought forward democratic consolidation as official part of the success criteria.

Conjoining politics to the economic debate, however, poses many problems. Thus, my thesis is a victim to many weaknesses common to these endeavors. In fact, today the literature is rather inconclusive even regarding which political regimes are most successful at achieving economic growth (Przeworski and Limongi 1993). The gradualist reforms in China succeeded and so did the Shock Therapy in Poland.

Meanwhile, both Gorbachev's 1985-91 gradualist reforms and Yeltsin's 1991-92 radical reforms failed. Clearly, there are factors beyond the speed of reforms that are decisive to success of reforms. I have pointed to the strength of institutions, but identifying or measuring the strength of institutions has been challenging and sometimes even confusing.

The first weakness of this thesis concerns assumptions. I make a basic assumption that the political consensus and control, whether in democracy or authoritarian regime, are pivotal to success of reforms. At times, however, as Przeworski (1991: 87) argued, democracy progresses despite political uncertainties and polarization, not as a result of their absences. Also, at times, as Rueschemeyer, Huber and Stephens (1992: 1) argued, "It is neither the capitalist market nor capitalists as the new dominant force, but rather the contradictions of capitalism that advance the cause of democracy."⁷³ It is entirely possible that political consensus and control, whether in a strong democracy or authoritarian regime, lead to bad decisions and bad results. It is also entirely possible that despite contradictions that a country succeeds in its reforms.

The second weakness of this thesis concerns circumstances. Sometimes, policy-makers may know what is best but be limited by dire circumstances. Undoubtedly, after disintegration of the Soviet economy, Shock Therapy 1.0 was made inevitable. Some might even consider the Shock Therapy 2.0 inevitable. However, considering the billions that Russia was robbed of, it is difficult to find grounds for justifying the loans-for-shares program. This massive reallocation of property permanently transformed not only the economic relationships within Russia but political ones as well. The middle and

⁷³ By "contradictions," they were referring to the class struggle between the upper-class, middle-class, the working-class and the lower-class.

the working class have lost their life savings, and very little of the public wealth was redistributed to them since *Oligarchs* hoarded the lion shares. Nonetheless, the shock therapists, particularly in the Yeltsin's administration, maintain that there were no alternatives remaining to finance the government deficit and keep the hard-liners at bay (Gaidar 2000). As an outside observer examining a policy that took place two decades earlier, it is very difficult to trump "inevitability" arguments because of information asymmetry and relativity of perspectives.

Over all, the research on radical economic reforms, particularly the Shock Therapy, offers much that remains to be explored. My reconsideration has been more of a bird's eye view and I have not gone down to discuss the country-specific or reformer-specific details. That is, I have enumerated three factors that undermined the strength of institutions (misdiagnosis of the patient's illness, medicine overdose and the problems associated with the doctors), but it is equally important to understand how exactly certain countries or certain reformers succeed in garnering political consensus and control.

The Shock Therapy has lost its glimmers that it enjoyed in the 1980s and 1990s and now the discourse has shifted to post-Washington Consensus. Nevertheless, the Shock Therapy continues to surface to debates concerning radical transformation of countries. For example, in the midst of unrest in Ukraine following the Crimean invasion, Balcerowicz recommended that Ukraine follow its suit to implement the Shock Therapy (Philips 2014). The Soviet Union has collapsed but the remains of its system live on in Cuba and North Korea. Thus, continuous refinement of the collective understanding regarding the Shock Therapy is still relevant.

Appendices

Appendix I

Six principles of War Communism:

1. All industry was nationalized and strict centralized management was introduced.
2. State monopoly on foreign trade was introduced.
3. Discipline for workers was strict, and strikers could be shot.
4. Obligatory labor duty was imposed onto "non-working classes".
5. *Prodrazvyorstka* – requisition of agricultural surpluses from peasants in excess of absolute minimum for centralized distribution among the remaining population.
6. Food and most commodities were rationed and distributed in a centralized way.
7. Private enterprise became illegal.
8. Military-like control of railroads was introduced.

Source: Holt, Rinehart, and Winston Holt 2003: Chapter 19, Section 5, Slide 6

Appendix II

Gorbachev summarized more radical economic reform in five points:

1. The extension of enterprise independence with self-financing;
2. *Perestroika* of centralized economic management;
3. A cardinal reform of planning, price formation, and the credit system as well as the introduction of wholesale trade;
4. A new organizational structure; and
5. Transition from centralized command management to self-management.

Source: 9 *Pravda*, June 26, 1987 as cited in Aslund 2007b: 29-30

Appendix III

This is the picture that dominates Russian public opinion:

1. Twenty years ago there existed a stable, developing, and powerful country, the Soviet Union;
2. Strange people (perhaps agents of foreign intelligence services) started political and economic reforms within it;
3. The results of these reforms were catastrophic;
4. In 1999–2000 people came to power who were concerned with the country's state interests
5. Life became better after that. This myth is as far from the truth...

Source: Gaidar 2010: xviii

Appendix IV

On October 6, the “Balcerowicz Plan” was presented on public television and in December the Sejm passed a package of laws, all of which were signed by the President Jaruzelski on December 31, 1989.

1. *Act on Financial Economy within State-owned Companies*, which allowed for state-owned businesses to declare bankruptcy and ended the fiction by which companies were able to exist even if their effectiveness and accountability was close to none.
2. *Act on Banking Law*, which forbade financing the state budget deficit by the national central bank and forbade the issue of new currency.
3. *Act on Credits*, which abolished the preferential laws on credits for state-owned companies and tied interest rates to inflation.
4. *Act on Taxation of Excessive Wage Rise*, introducing the so-called popiwiek tax limiting the wage increase in state-owned companies in order to limit hyperinflation.
5. *Act on New Rules of Taxation*, introducing common taxation for all companies and abolishing special taxes that could previously have been applied to private companies through means of administrative decision.
6. *Act on Economic Activity of Foreign Investors*, allowing foreign companies and private people to invest in Poland and export their profits abroad.
7. *Act on Foreign Currencies*, introducing internal exchangeability of the zloty and abolishing the state monopoly in international trade.
8. *Act on Customs Law*, creating a uniform customs rate for all companies.
9. *Act on Employment*, regulating the duties of unemployment agencies.
10. *Act on Special Circumstances Under Which a Worker Could be Laid Off*, protecting the workers of state firms from being fired in large numbers and guaranteeing unemployment grants and severance pay.

Source: Hunter, Leo and O'Brien-Lichtenstein 2013: 156-157

Appendix V

“Approximately 65 percent of Russia’s 107 million voters cast ballots on the four different questions”
Results on the April 25, 1993 Referendum of the Russian Federation:

Question	Yes	No
Do you have confidence in the President of the Russian Federation?	58.70%	39.20%
Do you approve the socio-economic policies carried out by the President of the Russian Federation and the Government of the Russian Federation since 1992?	53%	44.60%
Do you consider it necessary to hold early elections for the President of the Russian Federation?	31.70%	30.20%
Do you consider it necessary to hold early elections for the Congress of People’s Deputies of the Russian Federation?	43.10%	19.30%

Source: International Republican Institute, and Eric Jowett 1993: 36

Appendix VI

Soviet Union's Five year plans listed below. Stalin oversaw 1st to 5th. 12th became Gorbachev's *Perestroika*. Yeltsin's ascendance and dissolution of the Soviet Union disrupted the 13th.

- First Plan, 1928–1933
- Second Plan, 1933–1937
- Third Plan, 1938–1941
- Fourth and Fifth Plan, 1945–1955
- Sixth Plan, 1956–1960
- Seventh Plan, 1959–1965
- Eighth Plan, 1966–1970
- Ninth Plan, 1971–1975
- Tenth Plan, 1976–1981
- Eleventh Plan, 1981–1985
- Twelfth Plan, 1986–1990
- Thirteenth Plan, 1991

Appendix VI

Russia's Macroeconomic Indicators, 1990-2013

	GDP, %- change	GDP, USD billion	Industrial production, %- change	Inflation	Imports, USD billion	Exports, USD billion	Unemployment, %
1990	-3	568.9	-	-	-	-	-
1991	-5	559.6	-	160.4	-	-	-
1992	-14.5	489.8	-16	2508.8	-	-	5.2
1993	-8.7	457	-13.7	839.9	-	-	5.9
1994	-12.7	407.3	-21.6	215.1	50.5	67.4	8.1
1995	-4.1	398.7	-4.6	131.3	62.6	82.4	9.5
1996	-3.6	391.7	-7.6	21.8	68.1	89.7	11.8
1997	1.4	404.5	1	11	72	86.9	11.8
1998	-5.3	270.7	-4.8	84.4	58	74.4	13.2
1999	6.4	195.7	8.9	36.5	39.5	75.6	13
2000	10.0	259.4	8.7	20.2	44.9	105.0	10.5
2001	5.1	306.3	2.9	18.6	53.8	101.9	9.0
2002	4.7	345.1	3.1	15.1	61.0	107.3	8.0
2003	7.3	430.3	8.9	12.0	76.1	135.9	8.6
2004	7.2	591.0	8.0	11.7	97.4	183.2	7.9
2005	6.4	764.0	5.1	10.9	123.8	240.0	7.2
2006	8.2	991.0	6.3	9.0	163.2	297.5	6.8
2007	8.5	1300.0	6.8	11.9	223.1	346.5	6.0
2008	5.2	1658.0	0.6	13.3	288.7	466.3	7.6
2009	-7.8	1223.0	-10.7	8.8	183.9	297.2	8.0
2010	4.5	1525.0	7.3	8.8	245.7	392.7	7.0
2011	4.3	1904.0	5.0	6.1	318.6	515.4	6.0
2012	3.4	2002.0	3.4	6.6	335.8	527.4	5.1
2013	1.3	2095.0	0.4	6.5	343.0	523.3	5.6

Source: Retrived from BOFIT 2013. Original data from Rosstat, Central Bank of Russia. Unemployment data from the World Bank; in constant dollars.

Appendix VII

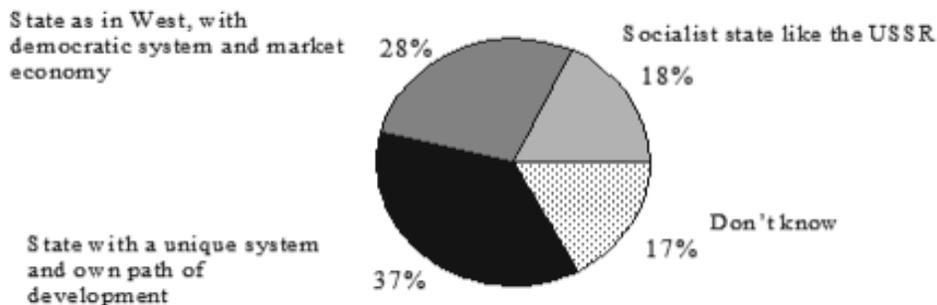
Q10. On what path do you think events in Russia are developing?

	All replies
	9%
Development of democracy	29
Return to old Soviet ways	10
Approach of dictatorship	15
Rise of anarchy	21
Don't know	24

Source: Levada Center, nationwide survey, 22 - 25 March 2013, N=1,601

Appendix VIII

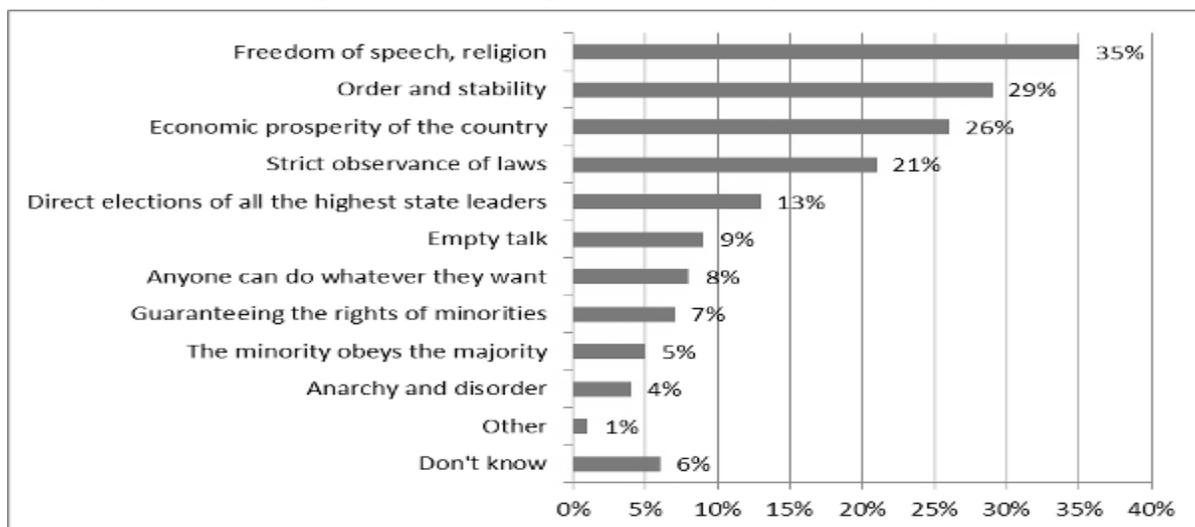
Q5. What type of state would you want to see in Russia in future?



Source: Levada Center, nationwide survey, 23-26 August 2013, N=1603

Appendix IX

What do you think is most important to be able to speak about democracy in this country?



Source: Levada Center nationwide survey, 17-21 December 2010, N=1611 www.russiavotes.org

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