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LESSONS OF THE RUSSIAN ECONOMIC TRANSITION

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You can’t understand Russia with your mind
You can’t measure it with universal dimensions
Russia has something special:
You can only believe in it.
--Fyodor Tyutchev

Abstract

Despite a good deal of controversy concerning the outcome and interpretation of Russian reform, there are some areas in which agreement is more widespread. These include the relatively strong trade performance, high savings, manageable unemployment, poor health statistics, and extensive mafia-style activity. Another widely-agreed upon observation is that the Russian economy remains less efficient than mature Western market economies. Nevertheless, I believe that Russia already has taken the steps that are essential to becoming a normal market economy. The essential reforms have been taken, providing large scope for market forces in a somewhat stable environment. Although simultaneously, there is a large amount of tax evasion and crime; the extent of government intervention in the economy is dauntingly high, and the potential for further intervention is even greater.

The transition towards a democracy has increased personal freedom enormously. But Smith has said that "Little else is required to carry a state to the highest degree of opulence from the lowest barbarism than peace, easy taxes, and a tolerable administration of justice." Russia is involved in a war in Chechnya, has an onerous tax code that helps drive businesses underground, and has a fairly inefficient and corrupt judicial system. Given such obstacles, it is perhaps amazing that the disappointing economic transition has achieved as much as it has.

1. Introduction

More than a decade of perestroika and its more radical successor have brought immense economic changes to Russia. Perhaps no one is completely satisfied with the result of the changes. Beyond a general dissatisfaction, however, there is little consensus over such

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2 I am grateful for financial support from the National Council for Soviet and East European Research, which however is not responsible for the contents or findings of this report.
3 Compiled by Ncseer staff from passages in the text.
fundamental issues as what the actual results have been, whether they generally have been
desirable, or whether alternative reform paths would have been preferred. The titles of two
recent books by prominent analysts illustrate the range of views: *Lost Opportunity, Why
Economic Reforms in Russia Have Not Worked* (by Marshall Goldman), and *How Russia
Became a Market Economy* (by Anders Åslund).

The lack of consensus is fueled by several factors. The first is the difficulty of actually
gauging the current state of affairs due to statistical shortcomings. Standard socio-economic
indicators provide only a narrow glimpse into the life of any society, but the view is singularly
Cyclopian and distorted in transitional socialist countries. There seems to be a larger
unrecorded sector in Russia than in most Western market economies, for instance, reducing the
reliability of output and income indicators.

Even accurate measures, however, would not end the debate. A second barrier to
assessing transitions from socialism is that the pre-reform situation itself is not well
understood. Standard market economic statistics generally are inappropriate or arduous to
collect in a fixed-price economy; inflation, for instance, cannot be measured reliably through
the usual types of price indices. The large second economy and the defense sector were
conspicuous mainly in their absence from Soviet official statistics. Ambiguity in the pre-reform
conditions is then reflected in attitudes toward the transition. Individuals with more negative
views of the Soviet economy tend, not surprisingly, to take a more optimistic stance towards
the reform era than those who think better of the pre-Gorbachev economic achievements.

The path between the murky starting point and the cloudy current milepost of reform,
therefore, does not lend itself to straightforward interpretation. With changed institutions, the
phenomena captured by statistics often change as well: price indices, for instance, begin to
measure inflation as price controls are lifted. Also changing are the incentives to report
information, or to misreport information; for example, bonuses for plan fulfillment contributed
to an exaggeration of output under central planning, whereas tax changes now provide novel
incentives to understate output. Strict censorship of unfavorable information also has been
eliminated. In addition, of course, there are many factors other than reform policies that
contribute to economic outcomes, so the marginal impact of reforms is almost bound to be a
contentious issue.

One consequence of this litany of measurement and interpretation problems is that
diametrically-opposed assessments of reform persist. An increase in measured unemployment is
sometimes viewed as a wholly unfortunate development, and sometimes as a signal of the
desirable hardening of budget constraints. Other examples include the decline in measured
industrial output and GDP, which to an unknown degree represents a reduction of value-
subtracting "output." Sometimes it seems that the Russian economy cannot be understood, or
measured with universal dimensions, but can only be believed, to echo the words of the 19th Century poet Fyodor Tyutchev. A second outcome of continued disagreement over the basic data of reform is that much of the discussion of transition takes place in terms of broad analogies and metaphors, such as shock therapy and leaped chasms.

In such an atmosphere it might be a bit foolhardy to suggest "lessons" of Russian reform. Any such lessons must not only take account of the impact of reform, but also involve a comparison, perhaps implicit, with alternative reform paths. While such comparisons can be informed by both economic theory and the experience of other countries, they cannot help but remain rather speculative. Further, it is quite possible that any lessons drawn today might be completely insupportable in the near future. Nevertheless, I will try to draw some lessons from the Russian reform experience. My approach will be not so much to assess the progress of privatization, liberalization, or stabilization—which could be altered quite quickly—but rather to search for some notions that would receive wide (though surely not universal) assent, irrespective of the view taken about the success of Russian economic reforms.

The rest of the paper is organized as follows. Section 2 notes a few conditions that are fairly surprising, in the sense that few analysts predicted their occurrence half a decade ago. Section 3 is devoted to how an analysis of Russian transition separates essential elements of economic success from peripheral elements. In part, this section suggests that reform in the Russian mirror has opened the eyes of Western economists to the extent to which their models were institutionally or socially specific. Section 4 is motivated by the prevalence and importance in Russia of economic behavior that circumvents the formal rules, and how such rule evasion influences further economic reform. Brief conclusions are offered in Section 5.

2. Five Surprises

Some changes that have taken place in the Russian economy have confounded most expectations. In this section, I briefly note five such changes—three generally positive, and two generally negative—in the areas of foreign trade, savings, unemployment, health, and criminal activity. These changes are noted only—I do not attempt to explain them, nor do I examine their future prospects. One preliminary point, however, is that even when interpreted in the least favorable light, reform has not resulted in a wholesale economic collapse. Measured average real consumption increased by 6% in 1993 over 1992, and by a greater percentage in 1994; following a fall in the beginning of 1995, real consumption recovered to 1994 levels by the end of the year. Furthermore, distributional changes have not resulted in new, massive destitution at the bottom of the income scale. Mroz and Popkin (1995, p. 26), for example, conclude: "Overall, we find little evidence of rapidly increasing economic hardship from 1992 to 1993 in Russia." The percentage of the population below the poverty line was 33% in 1992.
and 21% in November of 1995. The most dire predictions of famine and economic collapse, fortunately, have not been borne out, nor have there been riots or similar manifestations of deep social discord.

i. Foreign Trade Performance

Since the introduction of the Gaidar reforms of 1992, exports to non-CIS countries have increased substantially: by more than 17% (in dollar terms) during 1992-94, and by a further 31% during the first 9 months of 1995, relative to the same period in 1994. Imports from non-CIS countries were about the same in 1994 as in 1992 (following a dip in 1993), and began to increase sharply in 1995. Trade with CIS countries also has increased in 1995, after falling between 1992 and 1994. In total, Russia has been running a significant balance-of-trade surplus, about 2.5% of GDP in 1994 and 1995; simultaneously, Russia has not been servicing fully its debt, much of which it inherited from the Soviet Union.

A trade surplus, of course, is not necessarily a good thing, and to some degree the Russian surplus reflects capital flight, as export earnings are held abroad, and not used for the purchase of imports. Nevertheless, the large trade surplus is something of a surprise, and overall trade performance appears to have been very strong in recent years. There has been a realignment of trade away from the former socialist bloc and towards Western market economies, which on the whole is beneficial. The avoidance of any significant overvaluation of the exchange rate has played an important role in the export boom; high import taxes on some goods (such as automobiles) also have been a contributing factor to the trade surplus, but overall, there has been an enormous liberalization of foreign trade.

ii. Savings

Despite the massive inflation in recent years, the savings rate in Russia is remarkably high: savings of households and enterprises amounted to 33.5% of GDP in 1994, and 24.5% in 1995. Many of the savings are held in the form of hard currency, of course: 16.1% of household income was used to purchase hard currency in 1994, falling slightly to 15.0% by the third quarter of 1995, perhaps because of the stabilization of the ruble. And as with the trade surplus, a high savings rate is not an altogether good thing, particularly to the extent that it is motivated by precaution in the face of an uncertain environment. Combined with the data on real consumption during the years of radical reform, however, the high average savings rate is suggestive of income levels that are more than adequate for daily needs--although the distribution of savings is likely to be quite skewed.

iii. Unemployment

Despite significant employment turnover and a privatization program that has at least nominally moved most workers out of the state sector, the rise in measured unemployment in Russia has been quite moderate: from 4.8% of the workforce in 1992 to 8.1% of the
workforce in December, 1995. Furthermore, the social costs of unemployment and underemployment (which manifest themselves in various ways including wage arrears and forced short-time work) have been surprisingly small, and measured underemployment decreased throughout 1995. The conclusion of Rose (1994, p. 51) still appears to be valid: "...the effect of unemployment upon a household's economy is likely to be temporary and marginal."

iv. Health Indicators

The mortality and morbidity statistics that have been coming out of transitional Russia have been quite harrowing. While the relationship of the statistics to the underlying reality is, as with economic data, not always straightforward, nevertheless there appears to be some significant reduction in life expectancy. In 1994, male life expectancy was 59 years and female life expectancy was 72 years, a very large gap for developed countries, and a significant reduction from the 1986 figures of 65 years for men and 75 years for women. (There may have been a turnaround in 1995, with a fall in mortality, and during the first six months, a significant fall in infant mortality.) The underlying causes for the deterioration in many health statistics are difficult to discern. Nevertheless, the declining health picture, and in particular, the large drop in male life expectancy, generally was not an anticipated aspect of the reform era.

v. Organized Crime

Russian crime statistics began to increase during the Gorbachev era, and continued to rise through 1993. Statistics on organized crime show an even faster growth, with some 8,000 organized criminal groups known to the authorities by late 1995. The statistics, however, leave a good deal of room for interpretation, and the reported rise in organized crime would seem to have less disturbing welfare consequences in transitional Russia than in developed market economies. The fairly pervasive presence of individuals who appear to be in the private protection business, however, was not something widely discussed prior to the initiation of reforms. The ongoing drama of high-profile, business-related murders, and the seeming impotence of law enforcement authorities in the face of contract killings, also were unanticipated.

3. Complements, Substitutes, and Essential Reforms

Complements and Substitutes

The language of substitutes and complements is useful in organizing the discussion of economic transition. At a high level of abstraction, reforms tend to be complementary; for example, liberalized foreign trade is more likely to be socially beneficial if domestic prices also are liberalized, and monopolistic pricing can be limited by foreign competition. Claims
concerning the perils of partial reform measures generally are based on complementarity stories: absent a full package, it is often argued, reforms will fail, or even make matters worse.\textsuperscript{15} Johnson and Friedman (1995) demonstrate the extent to which existing reform discussions can be framed in terms of complementarities.\textsuperscript{16}

The notion of substitutes can be employed in discussing lower-level reforms. Specifically, a focus on substitutes highlights alternative means to the end of a normal market economy, as well as the multiplicity of types of market economies. Such a perspective avoids the danger of looking at market institutions in the U.S., many of relatively recent vintage, and associating them with necessary elements of market economies. Some examples include mutual funds, anti-monopoly agencies, an independent central bank, and even a modern legal system.\textsuperscript{17} Some of these Western-style institutions might be quite detrimental in Russian circumstances, while more appropriate substitutes might be helpful. Substitutes for Western-style institutions come in many varieties. Bringing transitions in-house via horizontal or vertical integration could be a useful substitute for public contract enforcement, for example; likewise with private protection services.

The assessment of economic outcomes is closely connected with notions of substitutes; after all, it is a fundamental economic approach to weigh foregone alternatives. Consider some of the issues connected to unemployment in transitional Russia. Subsidies to enterprises are one way, perhaps not the best nor the worst, to deal with the social costs of unemployment. Involuntary short-time work, delayed wage payments, or a strict bankruptcy provision coupled with unemployment benefits are other ways. The extreme reluctance in Russia to force firms into bankruptcy, then, need not represent a failure of reform. Rather, under Russian conditions, it may represent a sensible way of handling unemployment during the transition.

Development economists have long emphasized the importance of using appropriate technologies for economies with vastly different levels of income and wealth, and relative scarcities of capital and labor, than those in developed countries. U.S.-style market institutions, like U.S. capital-intensive industries, similarly are not universally appropriate. The functions performed by those institutions can and perhaps should be provided in alternative ways in transitional economies.

Substitutes exist at the most fundamental, microeconomic level, too. The work of Richard Rose, for example, indicates how individuals can substitute between official, unofficial, and social economies to earn income or improve their living standards.\textsuperscript{18} This work does not suggest that all forms of economic behavior are equally beneficial; clearly, individuals and firms who are successful in rent-seeking activity are not promoting society's interests to the same degree as those who engage in "productive" activity.\textsuperscript{19} But it does
suggest that a dearth of Western-style "official" activity does not imply a similar paucity of useful economic activity.

What is Essential for Successful Economic Transition?

The discussion of substitutes and complements relates to the difference between essential and inessential elements of reform. What economic reforms are essential—as opposed to merely desirable—for a transition that is going to have a fighting chance at producing a "normal market economy"? First, it should be noted that the goal of achieving a normal market economy appears to continue to be supported widely in Russia, although there is deep disagreement over the desirable speed, scale, and scope for reform. Second, there are many varieties of "normal market economies," and even if successful, the Russian version will not necessarily appear to be similar, at least in its particulars, to other market economies. Nevertheless, there is a common-sense notion of which economies are market-based and which are not, though like elephants, market economies might be easier to identify than define. My rough characterization is that a normal market economy requires that market forces play the primary role in resource allocation, and that they do so in a relatively stable environment.

In Leitzel (1995b, p. 26), I suggested four components of reform that needed to be implemented early in a successful transition to a normal market economy: (1) near complete price liberalization; (2) a liberal environment for private economic activity; (3) an explicit social safety net; and (4) an explicit taxation system. These are reforms for which adequate substitutes cannot easily be found. Further, the four general reforms tend to be mutually complementary.

The argument for free prices (1) and free enterprise (2) is straightforward: in the long-run, market-determined prices, and the freedom to respond to those market signals, are required to avoid extreme resource misallocation. This is not to say that some or even many prices cannot be fixed (nor, as China’s experience suggests, that inframarginal prices cannot be regulated), that taxes cannot influence prices, or that there cannot be a host of government restrictions on private enterprise. These reforms simply reflect the requirement, noted above, that in a normal market economy market forces play a major allocative role. As Adam Smith wrote,

"The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security is so powerful a principle that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations."21

The other two reforms that I have suggested are essential relate to the provision of a relatively stable environment in which market forces hold sway. The social safety net provides
a degree of micro-level stability. The need for a new, explicit social safety net is that the
previous net consisted in large measure of low fixed prices for many basic consumer goods and
a full employment policy. Price liberalization and free enterprise (which lessens the relative
importance of state-owned enterprises) tend to undermine the pre-existing net. Substitutes for
the old system, therefore, are useful in limiting the economic distress of low-income
individuals and those who are disadvantaged by the economic reforms. An explicit safety net
need not take the standard U.S. form, however. Under Russian conditions, for instance, it
might be sensible for enterprises to continue to play a large role in the safety net and the
provision of social services. Infra-marginal price controls for basic consumer products also
might continue to contribute to a viable social-safety net. Identifying those who are most in
need is not easy during the transition. Incomes are hard to measure, and their relationship to
underlying consumer welfare is unclear. Furthermore, relative welfare might change quickly
during the reform period. Price controls and queue-rationing then might provide better
targeting of social benefits than could be expected by a noisy means test.22

Another element of microeconomic stability, connected to the free enterprise reform
discussed above, is some degree of protection of private property rights. Again, however, there
is wide scope for how this requirement is met. Many assets can remain in state hands. Private
property rights need not be given explicit legal recognition, nor need they be protected through
public channels. But a reasonable degree of security of private rights, existing over a
significant portion of the economy, is necessary both to have meaningful free enterprise and
some micro-level stability.

The more commonly-discussed element of transitional stability is that concerned with the
macroeconomy, and this is where explicit taxes play a role. As with the social safety net,
economic transition tends to undermine the pre-existing system of taxation, much of which was
implicit in the price structure and state ownership of enterprises. Without a substitute for the
implicit taxation system, then, macroeconomic stabilization is unlikely. Once again, however,
the substitute could take various forms, including increased state borrowing, decreased state
expenditures, or even foreign aid. It is likely, however, that some explicit taxes, direct and
indirect, will be necessary to achieve macroeconomic stabilization. Further, the need is not so
much for stabilization in the sense of near-zero inflation, but rather the avoidance of very high
rates of inflation or hyperinflation.23 The experience of many countries indicates that
economic progress can take place under sustained high inflation, though this may be easier to
accomplish in a relatively secure society than in one that is attempting a massive economic
transformation. While, all else equal, macroeconomic stabilization is a desirable element of
reform, it is only the avoidance of severe destabilization that is necessary for a successful
transition.
One lesson that has been brought home by Russian experience is the close connection in transitional societies between macroeconomic stabilization and microeconomic adjustment. Hardened budget constraints for firms and limited transfer payments to individuals play an important role in keeping down the budget deficit (macroeconomic stabilization), and in providing profit-making incentives (microeconomic adjustment.) Price liberalization is another reform element that contributes to both macroeconomic stabilization and an improved microeconomic environment.

This list of necessary elements of transition is much shorter than its complement, all those elements that are not essential. Included among these are privatization, anti-monopoly policy, military conversion, ruble convertibility, and foreign trade liberalization. Again, many of these (and other) measures would be beneficial for the Russian economy. In general, however, and in recognition of the opportunity costs imposed by the limited administrative capacity of the state, they are much lower priority than the "essential" reforms listed above. And the essential reforms do not point to an unique economic outcome. Free enterprise in a relatively stable and undistorted environment is essential; whether the result is a good deal of barter trade, or conglomeration, or Western-style corporations, is not essential.

The preceding discussion provides a basis to comment on the debate over the so-called Washington consensus, those "neo-liberal" transition policies associated with the Bretton Woods institutions. Many of the policies comprising the Washington consensus do not appear to be essential in the early stages of transitions from socialism--though in the longer term, they generally would be desirable and perhaps even necessary. For example, an "outward orientation" and a favorable attitude towards foreign direct investment, while perhaps extremely important in smaller economies, are secondary to (and not necessary for) an improved domestic economic environment in Russia. Privatization of existing state-owned enterprises is not necessary (as the cases of Poland and China suggest), though subsidies to state-owned enterprises must be sufficiently limited to prevent hyperinflation. Even welldefined, publicly-protected property rights seem to be as much a result as a cause of economic development. Chinese township-village enterprises, for example, have been very successful despite unclear property rights.

In concluding this discussion, let me note that I believe that Russia already has taken the steps that are essential to becoming a normal market economy. Market forces have wide scope, though the extent of government intervention in the economy remains well above that of typical Western levels. A reasonable level of macroeconomic stabilization appears to have been achieved, perhaps tenuously, in 1995: inflation for the year prior to February, 1996, was 89%, the first double-digit annual inflation since the Gaidar reforms. The system of pensions, disability, severance pay, and unemployment compensation seems to have provided a
serviceable safety net. There is sufficient protection of property rights to sustain an extensive amount of private economic activity in Russia, though business-related violence remains a major risk.

What remains, then, is for Russia to nourish the gains that it has already made, while moving ahead with some of the lower priority measures previously mentioned. There are still many dangers on the horizon. Macroeconomic stabilization, for one, could rapidly be undermined via increased state credits, or by a diminished ability to collect taxes. Perhaps more likely is that the extent of market forces, currently too narrow, could be restricted further in response to real and perceived economic difficulties. Such an evolution could threaten the primary role of markets in resource allocation, and re-establish, perhaps unconsciously, a planning-style system.

4. Learning from Evasion

Rules restricting private economic activity were pervasive in the Soviet Union, and they were pervasively broken. The Soviet second economy probably offered positive net social benefits, raising living standards and in many instances even promoting plan fulfillment. At the same time, underground economic activity created significant gaps between actual economic outcomes and what was captured in official statistics, distorting the information available to the central authorities.

Liberalization and the demise of central planning during the Russian transition have resulted in substantially loosened controls on private economic behavior. Economic crimes that were prevalent in the pre-reform system, such as circumvention of price controls or "speculation," are, for the most part, no longer against the rules. Nevertheless, there remains a good deal of corruption, illegality, and underground activity.

With large changes across a wide spectrum of policy areas in such a short period of time, it is unsurprising that there have been opportunities to evade the new rules in transitional Russia. Privatization offered a very significant, one-time opportunity for evasive activities that included, besides insider machinations to retain control of enterprises, bogus voucher investment funds and counterfeiting of vouchers. In many cases the enforcement of the new policies (such as the VAT) had to start from ground zero. The development of a financial market also presented entirely new types of crimes which Russia had no experience in policing.

Does the ongoing evasion of economic regulations continue to offer positive net social benefits? Because the official rules of the economic game have been improved, the benefits to evasion of those rules would seem to be reduced. Nevertheless, the rules governing Russian economic activity remain significantly more constraining than in advanced Western market economies, with a vast array of licensing, tax, and other regulations. The transition also has
brought increased uncertainty as to what the rules really are and how they will be enforced.\textsuperscript{34} The \textit{de facto} rules in some instances are informal, reflecting the substantial discretionary powers of government authorities.

Some forms of economic crime, such as the evasion of trade restrictions or local price controls, continue to bolster the Russian economy. Widespread corruption does provide one avenue around excessive government regulations, giving business people some protection against bad rules or arbitrary government intervention.

At the same time, economic crime comes with many costs, not the least of which are contract killings and the violence that accompanies protection rackets. Such violence also levies an indirect toll, by discouraging investment from would-be entrepreneurs, especially foreigners and those engaged in small businesses. More mundane costs include the higher inflation and increased macroeconomic uncertainty that stem from tax evasion, which also leads to poor information about actual economic conditions and the impact of reforms, as economic activity is unrecorded. Further, an environment of widespread illegality can be unfair, and certainly contributes to a perception of unfairness. Individuals who do well in such circumstances often are those with the fewest scruples about breaking rules.

Economic crime, however, can promote reform, particularly in governments that are responsive to the preferences of their citizens. Widespread evasion of a rule serves to bring the rule to the attention of policy makers, who then can respond with increased enforcement, rule liberalization, or another policy change. Wide-scale evasion of "good" rules, such as those against violent crime, will tend to be met with stricter enforcement or harsher punishment. Inefficient rules that are violated with abandon, however, will be more likely to be altered, or become effectively dead letters through a lack of enforcement.\textsuperscript{35} The ability to evade rules helps to prevent increased government regulation, and in some cases, leads to a rationalization of laws. Tax evasion in Russia, for instance, is leading to simplification and rate reduction in the tax code, and unrecorded foreign trade is helping to reduce the reliance on export taxes and import tariffs. The potential for corruption in general, clearly significant in Russia, serves as a reason to limit the discretion accorded government officials.

Evasion of rules in one area tends to induce responses in other areas. For example, the possibility for policemen to earn money through bribes lowers their official salaries. And while firms are evading their legal obligations to the state in tax payments, the state is evading its legal obligations to firms in terms of payments for goods, which in turn is partly responsible for delayed or non-payment of wages, and further tax evasion, etc.\textsuperscript{36}

Evasion of economic rules in Russia seems to be reaching an "equilibrium" of sorts. Real wage arrears peaked in July 1994, and one year later had fallen by more than 40%; real inter-enterprise debt peaked in September 1994, and by June 1995 had fallen by nearly 35%.\textsuperscript{37}
Even officially recorded crime fell nearly 6% between 1993 and 1994; while overall crime increased in 1995, many severe violent crimes showed downward trends. Strengthened resolve with respect to macroeconomic stabilization also has decreased access to legal "loopholes" in tax laws, and limited the subsidies through which localities can sustain price controls.

The "equilibrium" that is emerging in Russia, however, remains far from a U.S.-style market economy. The continued entanglement of the government in the economy is quite stifling, and shows little signs of diminishing. This entanglement is the most important source of the uncertainty over what the laws actually are—the de facto law essentially remains at the discretion of local officials, upon whom the local judiciary also is dependent.

5. Conclusions

Despite a good deal of controversy concerning the outcome and interpretation of Russian reform, there are some areas in which agreement is more widespread. These include the relatively strong trade performance, high savings, manageable unemployment, poor health statistics, and extensive mafia-style activity. Another widely-agreed upon observation is that the Russian economy remains less efficient than mature Western market economies. Nevertheless, the reforms that are essential for laying the basis for a normal market economy have been taken, providing large scope for market forces in a somewhat stable environment. Simultaneously, there is a large amount of tax evasion and crime; the extent of government intervention in the economy is dauntingly high, and the potential for further intervention is even greater.

Adam Smith was invoked earlier in noting how self-interest, combined with freedom and security, could overcome many obstacles to creating wealth. The transition towards a democracy has increased personal freedom enormously. But Smith also said that "Little else is required to carry a state to the highest degree of opulence from the lowest barbarism than peace, easy taxes, and a tolerable administration of justice." Russia is involved in a war in Chechnya, has an onerous tax code that helps drive businesses underground, and has a fairly inefficient and corrupt judicial system. Given such obstacles, it is perhaps amazing that the disappointing economic transition has achieved as much as it has.

References


**Endnotes**

1. There is already a large and valuable literature on lessons drawn from post-socialist economic transitions. Åslund (1994), Ellman (1994b), and Balcerowicz (1994) are three contributions that include the word "lessons" in their titles.

2. *Russian Economic Trends*, Vol. 4, No. 2, 1995, p. 56, and *Russian Economic Trends*, Monthly Update, 16 January 1996, p. 12. After enumerating in the Introduction the shortcomings of Russian statistics during the transition, it would be disingenuous of me to rely on their precise values as the basis for sustaining an argument; therefore, I try not to do so, though I do report some statistics while omitting specific discussion of their reliability. One general precept is that because of the movement from a fixed-price to free-price regime
that took place largely in January, 1992, statistics in value terms (such as real consumption) before and after 1992 are not comparable.


6. During a transition in which future incomes are expected to be higher than current incomes, the benefits of a trade surplus are even more questionable.

7. Russian Economic Trends, Monthly Update, 19 October 1995, p. 6. The reliability of official savings data is problematic--so much so that the authoritative Russian Economic Trends has now stopped presenting official income and savings statistics. Nevertheless, even if the figures overstate actual savings by 100%, there is still a significant amount of saving taking place in Russia.

8. Russian Economic Trends, Vol. 4, No. 3, 1995, p. 58. The figures are based on gross purchases by citizens of hard currency from commercial banks; the net figure would be smaller, though other channels for acquiring hard currency exist.


15. See, e.g., Murphy, Shleifer, and Vishny (1992), or Leitzel (1995b, pp. 5-7).


17. Posner (1995) offers a discussion of how the legal systems in the transitional societies might differ from that in the U.S. Polanyi (1957, p. 270n) describes the "economistic fallacy" as the "artificial identification of the economy with its market form." Weitzman (1991) offers a critique of privatization schemes that involve such advanced institutions as stock markets and mutual funds.


19. Rose (1992), for example, distinguishes between activity that promotes a civil economy and activity that leads to an uncivil or a parasitical economy.

20. Non-economic reforms, such as those in the political arena, might also be necessary for successful transition, but the discussion in this paper will be limited to economic reforms.


22. This situation is modeled in Alexeev and Leitzel (1996). Barzel (1974) notes that the poor are more likely to wait in line for goods with low income elasticities and high price elasticities--e.g., those for which close substitutes are available in private markets.
23. This point is made in Portes (1994, p. 1184).

24. See, e.g., Kaufmann (1994, p. 65). Rodrik (1996, pp. 16f), however, discusses the importance of the distinction between microeconomic distortions and macroeconomic stability.

25. See Leitzel (1995b), particularly chapter 8, for a discussion of these elements. The importance of a liberal foreign trade regime is increased in countries with smaller domestic markets than Russia.


29. Some of the discussion in this section derives from Leitzel (1995a).

30. Montias and Rose-Ackerman (1981) distinguish corruption that promotes the goals of the official organization ("organizational corruption") from corruption undertaken for private benefit ("individual corruption"). Whether plan fulfillment actually promoted the welfare of Soviet society is another matter.


32. It should be noted that the alternative to official privatization was not itself free of questionable activity. Prior to the voucher privatization, spontaneous privatization that was quasi-legal at best was putting enterprise assets or their associated profit streams in the hands of managers. See Johnson and Kroll (1991).

33. Loosely speaking, a "good rule" is one that prohibits or regulates privately profitable but socially undesirable activity, such as theft; a "bad" rule, then, is one that interferes with Pareto-improving, voluntary exchanges. Even good rules, however, benefit from some evasion. Policies are not complete, in the sense that they do not prescribe precise actions for every individual under all possible "states of the world." Rather, rules tend to be quite coarse, and are unresponsive to detailed individual preferences or circumstances. Occasional avoidance or evasion offers an opportunity for improved actions based on more complete information.

34. The long stability in the pre-reform system made the de facto rules well-understood, even if they were not congruent with the de jure rules. See, e.g., Grossman (1977).

35. This discussion echoes Rubin's (1977) analysis of the pressure towards efficiency in common law. Leitzel (1995a) suggests that small-scale evasion of rules is less likely than widespread evasion to promote beneficial policy changes; rather, limited evasion serves as a substitute for such reforms. The conclusion that evasion is an effective force in promoting desirable policy reforms is muted if the policy makers are the ones who are benefiting from the evasion, and if they cannot assure themselves of similar benefits in the reformed system.


37. To some degree the declining wage and inter-enterprise arrears may be offset by tax arrears. It should also be noted that reported increases in some crimes may reflect the improved enforcement capabilities, as opposed to an increase in the amount of crime itself.