

Is Russia on the Road to Recovery?

by Alvin Rabushka

Alvin Rabushka is senior fellow at the Hoover Institution.

Since 1991, living standards in Russia have fallen by 47 percent. The 1990s have witnessed serial defaults, currency devaluations, and continuous contraction. This year, for the first time, Russia is enjoying a 10 percent increase in industrial output and 7 percent economic growth. Tax and payroll arrears are being reduced. Foreign debt is being paid on schedule. A new president has pushed through a 13 percent flat tax, a balanced budget and is working on land and regulatory reforms. **Has Russia turned the corner?**

The jury is still out on this question. This year's growth is largely attributable to high oil, gas, and other commodity prices. Foreign exchange earnings are helping fuel Russian economic activity. But true structural reform has yet to begin.

For years, the International Monetary Fund and other foreign experts have advised Russia to follow the trinity of stabilization, liberalization, and privatization (SLiP). Russia has clung faithfully to this path. The advice rested on the conventional wisdom that these policies would transform Russia and other postcommunist countries into market economies. But SLiP failed in Russia and other postcommunist countries. Why?

The Russian economy under central planning can be likened to a single nation-enterprise. When communism collapsed, the government lifted its economic controls over wages, prices, foreign trade, and capital flows. It rapidly privatized enterprises. However, these enterprises—a coordinated

network of suppliers and producers under communism—quickly formed a network of their own outside government control.

The new network did not behave as enterprises do in market economies. Rather, enterprises began to socialize income, to the same degree as had occurred in Soviet Russia. First, they practiced tax nonremittance on a large scale, collecting taxes from the public but withholding a large portion from the government. In short, they confiscated public income. Second, to compensate for the fiscal shortfall, the government printed money to provide banks with cash to subsidize enterprises, hoping to reduce tax non-remittance. The resulting inflation resulted in the confiscation of public income and financial assets. The autonomous network of enterprises transformed itself into a new form of socialism, what we can call enterprise network socialism. Enterprises are private, exchange is free, but income is socialized and redistributed.

The focus of the foreign experts who recommended SLiP to Russia's young reformers was on the establishment of private property, whereas it should have been on the establishment of private income. They failed to see that private property, free movement of prices, and stable fiscal and monetary policies do not, and did not, prevent the socialization of income.

Breaking up the network and privatizing income are the keys to sustained growth. If the network persists, Russia will continue to suffer more defaults and contraction. A full exposition of these themes can be found on the Hoover Institution's topical web site at <http://www.russiaeconomy.org>