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The transition from planned to market economy in Russia: process and consequences

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Introduction

The economic system of modern-day Russia, despite having been classified as a market economy from the early 2000s, is to a closer look a very peculiar configuration of such.
Many of the constraints that operate today in its workings, from a substantial role of the Russian State, overreliance on natural resources and underdeveloped commercial law, to name a few, are certainly peculiar to the Russian case.

In observing such reality, it is impossible not to recall that the market economy of modern-day Russia is of relative new existence, being the hard-fought outcome of the drastic circumstances that came about after the fall of the Soviet Union. The question of interest then becomes attempting to understand, if, and in which measure, the economic history of what is now Russia, has impacted its singular economic framework.

Such task is of undoubted benefit as, first of all, Russia is to this day a crucial player in the international arena, one which, like all States, is constrained in its internal and foreign policy by the make out of its economy. Understanding the basic characteristics of the latter is then valuable in identifying the constraints and opportunities that determine the limitations of a country's margin of action, as well as different development routes that may be pursued to increase its capacity for such. In the case of Russia, having such ability is especially helpful since, given the ruling elite's current aim to renew the country's Superpower status, economic availabilities, and the ability to enhance and vary them, are critical to ensuring such goal can be sustained. Furthermore, aside from the ramifications concerning Russia, the shift that occurred after the demise of the Soviet Union, covering not just the economy but also institutions and society, can undoubtedly be regarded as the biggest example of ‘structural change' to a country’s essence in the twentieth century. The manner in which such a transition was carried out, with its achievements and failings, can undoubtedly provide important models which could be used in future scenarios involving the challenge of development.

To ensure that the analysis of Russia’s transition to market economy is duly conducted, hence providing a satisfactory level of understanding of the process, it is of key importance to accurately select relevant variables of interest. The issue with such requisite in this specific case is mainly linked to the context in which such monumental change took place in Russia. The transition that could be regarded as specific to the economic dimension has in fact been concomitant to a wider restructuration of what could be considered as the pillars of the State itself, institutions and society. The outcome of such progression is furthermore heavily influenced by an even wider array of factors as both the basis for reform and the capacity to react to such were rooted in a variety of different causes that were the result of the peculiar economic history of the country. On top of this already complicated landscape it is also important to note that the fall of the Soviet Union and its consequent developments were enshrined with a strong ideological meaning, as the disappearance of the Socialist way of organising reality effectively failed, creating an intense enthusiasm towards, amongst other elements, the introduction of the market system in what was for almost 75 years the practical translation of the alternative to the Western model.

The approach used in this study will seek to recognize the complexities of such a scenario. in addition to and by considering the key stages of history of the Russian economic organization, other components reflecting sociological and institutional background will be analysed. Such method will ensure a more comprehensive understanding of the subject matter. Since other variables may have contributed to a specific characteristic of the economic layout of Russia, they must be duly considered in the bigger assessment on the process and outcome of the transition to market economy.

The subsequent work will then be structured as follows. In the first chapter, the key events preceding the fall of the Soviet Union will be analysed, with a focus on the main stages of economic development in Soviet Russia. The second chapter will deal with the fall of the Soviet Union and the initiatives for economic reforms that emerged after this event. The third chapter will contain an assessment of how all the previously analysed variables have impacted the current framework of Russia's economy.

Chapter one

1.1 Pre-Soviet Russia and its economic organisation: a starting point for industrialisation

Despite the apparent oddity of beginning the analysis of what are the latest developments in Russia's economy from the Tsarist period, some key structural factors that persist to this day had their roots in this period. The main element to consider in this analysis is the basis from which Russian industrialisation developed. Unlike other powerful industrial nations like Germany or the United Kingdom, Tsarist Russia was still lagging behind in terms of industrial capacity at the beginning of the XX century. The main reason behind this key difference lays mainly in the substantially different bases for industrial development.

The process of industrialisation is an undoubtedly complex phenomenon to analyse, one of which the causes at its origins are intertwined and difficult to pinpoint. Still, in light of the comparison between its development in Western Europe and in Russia, some elements clearly assume a highlighted role. One of the main factors to analyse in this regard is linked mainly to the evolution of the agricultural sector, and the consequence it had on the labour force employed in it.

The starting point for both Russia and the totality of European States was a condition in which agricultural labour was regulated through the relations of serfdom. Serfdom disappeared in Europe between the XIV and the XVIII century, a process kickstarted by the raise in bargaining power accrued by agricultural labourers after the demographic shock caused by Black death epidemics. This first emancipation of agricultural labour was the beginning of a process that could be said to have evolved and culminated in what is the exemplary case of the Enclosures in England. This specific episode marked the beginning of a new model for agriculture, one dependent on better technologies and producing better yields, all while reducing the number of workforce in the sector. This orphaned labour could then, as a result, be employed in the new industrial sector, kickstarting its development.

Albeit the case of England being particular, and the focus on just labour mobility being certainly too narrow to explain the phenomenon of the industrial revolution as a whole, it is still indicative to explain a somehow fundamental difference between the standing of Europe and the standing of Russia in the path to industrialisation. Whereas many of the countries in Western Europe enjoyed a somehow organic and gradual development of the conditions necessary for industrialisation, towards the end of the XIX century Russia found itself in a position of having to somehow kickstart the process artificially.

The necessity to modernise Russia became apparent after the defeat in the Crimean War (1853-1856), an event that made the lag between the Empire and its western counterparts apparent. Such modernisation, a concept by this point translating into industrialisation, began by reforming the agricultural sector. This effort translated first in the Emancipation Act (1891), and then in subsequent land reforms. Their main intent was to produce the same effects that centuries of evolution had in Europe, namely shifting the core of society from the agricultural domain and increase productivity of the sector. Those two shifts would then hopefully translate in both an increased availability of labour and growth in demand to support industrialisation, as well as improving the efficiency of the agricultural sector.

Whether such reforms actually brought about the desired outcome is a matter of debate. The Emancipation Act, albeit succeeding in freeing the serfs, still had critical shortcomings. The issue lied mainly in the fact that peasants were allotted scattered and small portions of land of which they did not have direct ownership. Control over production and labour mobility was in fact relinquished to a commune like institution, the *mir*. The commonly recognized consequence of such arrangement, as per the dominant theory of Alexander Gerschenkron (1965), singles the commune as the main cause for slow increases in productivity and scarce emancipation of the peasant class, with subsequent reduced flow of labour. Such issues were to be fixed by land reforms promoted by Stolypin in 1906. Their substance aimed not only at creating bigger and unified plots of land, on the model of English allotments, but to relinquish the property rights of such directly to the peasants. This substantive change aimed at creating increased yields of land and possibly promote greater social mobility, since peasants could now lease or sell their land directly.

The Stolypin reform, followed by further amendments in 1910 and 1911, still encountered some major difficulties as the intentions set out at the institutional level clashed with practical obstacles and took a relative long time to implement. By the October Revolution (1917), the agricultural sector was still entangled in a system which fused both the institution of the *mir* and privately owned land allotments of all sizes. The outcome of the reform was then somehow mixed as it partially achieved its aims. The number of privately owned land allotments raised, but sparsely and not replacing communes, whereas labour mobility increased but mainly due to unemployment deriving from the confused situation in the countryside.

The attempt to reform the agrarian sector went hand in hand with the efforts to boost the industrial sector, its productivity, and diversification. The debate on the issue mainly revolves around the role the Tsarist State had in the process, with some pointing out that Russia's industrial growth was somehow following the secular trend, meaning that output was rising through the last decades of the IX century, as was demand for goods in the rural communities (Gregory, 1980). It is still important to note that, given the result of the agricultural policies being far from a complete success, the necessity for additional intervention was somehow fundamental to boost favourable conditions for industrial growth (Von Laue (1963)).

Towards the end of the XIX century, and for the first decade of the XX century, the architect of the grand plan to boost industrial capabilities was the Minister of Finance, Sergei Witte. The Witte System was a complicated combination of reforms centred on a number of State-sponsored measures aimed at increasing Russia's industrial capacity. The main driver of such reforms was definitely the State, which not only provided direct subsidies to companies but also frequently purchased their goods at inflated prices, all while making direct orders to factories. To boost the sales and productivity of industries, under the guide of Witte, the State also undertook a massive project of railway construction, the Trans-Siberian railway being the most famous line. This Major State project aimed at boosting mainly heavy industry such as coal and steel which during the last decade of the XIX experienced a growth of 6%, double the growth of light industry.

Another key element of the Witte System revolved around ensuring a growth in foreign investment in Russia, aim that was achieved by putting the Ruble on the Gold Standard, hence increasing its credit reliability. Despite successfully managing in such endeavour this reform came at a massive cost since it required increased taxation of which the burden fell primarily on the already struggling peasant class. Furthermore, the attracted investments, coming primarily from France and Germany, served mainly to restore the struggling State Budget, rather than providing a real boost to industry.

The last pillar of the Witte system revolved around improving the trade balance. The program aimed at boosting exports, usually of agricultural products withdrawn more or less forcibly from the countryside, whilst rising the costs of imports. Still, such balance was hard to be maintained especially due to the nature of imports, constituted primarily by technical equipment necessary to the development of industry.

In the end, the policies of Witte hit an impasse in the years around 1905, especially due to the strain imposed on the agricultural sector, of which productivity decreased, and for the general conditions of the peasants. The latter were in fact neglected by Witte’s program and, on the contrary, charged with sustaining the burden of the reform by being subject by high levels of taxation. Such situation, paired with the uncertainty caused by the Emancipation Act, and then by Stolypin’s reform, ended the hopes of a sound industrial development. These events of the last Tsarist years, with their challenges regarding industry and agriculture, offer a valuable example of the difficulties that would plague the Russian economic organisation for the decades to come.

A critical determinant in providing stable underpinnings for industrial growth was how agricultural production would be managed to increase productivity in a stable manner while also improving peasant conditions. Both Lenin and Stalin devised distinct answers to the problem, with varying consequences and methodologies. The essential takeaway, though, is how the 'countryside issue' constituted a substantial burden for the economy's expansion, forcing efforts to organize its functioning from above, oftentimes with uneven outcomes. The problem with such a scenario was that policy remedies to agricultural output challenges had to be constructed from above, frequently overwhelming an unprepared peasantry with disastrous repercussions on production.

During the Tsarist Period, the course of industrial development included features that would later represent themselves. The need to industrialize was followed by determined efforts by the leadership to enhance industrial production, frequently focused on hard industry sectors that could be easily stimulated without the requirement for growing popular demand for commodities. The entire process was followed by an increase in national debt, which made the position increasingly precarious over time. Overall, improvements in the industrial sector would have been moderate and certainly slower without the intervention of the State, which was already responsible for planning the path of industrial development prior to the revolution, with some even comparing such efforts to the nature of Five-Year Plans (Von Laue, 1953).

1.2 The First Socialist Years, the New Economic Policy

Following the October Revolution of 1917, Vladimir Lenin's Bolshevik party came to power. The economic situation at the time was catastrophic, with the Tsarist State having defaulted due to debt and military expenses. The situation was compounded by the country's protracted Civil War, which ended only in 1921. As a by-product of such a protracted period of conflict, the new ruling class was faced with the tremendous burden of rebuilding the economy from near ashes, an effort that had to be consistent with the socialist doctrine.

During the period so-called of war communism, the Bolshevik government proceeded with the nationalisation of industry and centralised control of economic planning and foreign trade, measures designed to achieve a better control of resources during the War effort. This strict control of the economic system, somehow coherent with the socialist ideology, proved to be unsustainable for its long-term revival. The proposed solution was then a system that replaced the most critical elements of the war economy with a framework that would allow a fast rebound of crucial sectors.

The main focus of the NEP (New Economic Policy) was agriculture. This specific sector, already in a difficult spot after the last decades of the Tsarist regime, was furtherly suffocated by the efforts of War Communism. This situation resulted in significant shortages, if not proper famine in some regions, and an overall decrease in productivity. This problem was crucial not only for the disruption of food supply, but because the peasant class constituted the majority of the population in Russia. The government of Vladimir Lenin then began to realise that even if the ideological framework that allowed them to successfully carry out a revolution was focused on the rights of the industrial workers, this social class constituted only 10% of the population in Russia at the time. There was then no other solution to ensure stability in the country than assessing the problems of the peasantry. This was especially challenging because there was no specific instruction in Marx's socialist doctrine on how to deal with the problem of organizing the peasantry in a socialist manner, as the philosopher himself envisioned the

Socialist revolution taking place in countries like Germany or France, which already had an established industrial social class.

The framework around which the NEP was constructed around was focused on the replacement of forced collection and distribution of crops by the State by the Tax in Kind policy. This system would entail that the State would appropriate only a fixed, and possibly low, percentage of the produce of the land whilst giving the freedom to peasants to either sell or keep the remanent. Private property was not reinstated but according to the Land Code of 1922, allotments were granted gratuitously by the State for private use and then, by a decree passed in 1924, allowed to be leased and to be farmed by privately hired labour. The Labour Code of 1922 also codified the possibility to be privately employed or self-employed. These provisions then established a more or less private agricultural sector while maintaining the institutions of cooperatives and state-owned enterprises in other sectors, especially that of industry. The system that was in place in the first years of Socialist Russia was one of a ‘Mixed Economy’ in which ‘private’ and state property coexisted.

Overall, the productivity of agriculture somehow increased, even though the main motivation behind the increase was mainly driven by the incentive of salary, rather than for the enthusiasm for the mechanism of production itself. The role of the Communist party then was to both motivate and control the process of productivity through the mechanism of the party apparatus and administration. This effort, apart from supplying an answer to the problem of motivation, also contributed to curb the menace of introducing capital methods of production in the economic system. The 'lack of theory’ in the socialist handbook on how to reform the agrarian sector, was in fact accompanied by a well-structured notion that the capitalist mode of conducting market relations was intrinsically flawed, creating a significant amount of embarrassment in how the benefit of maintaining a ‘mixed economy’ clashed with the general idea of which should be the motives behind productive effort.

The roots for the ultimate demise of NEP lied specifically in this issue as, despite its functionality, which was undoubted, its roots lied in the allowance of capitalist market relations based on the interest of the single, rather than the community. Despite Lenin interpreting such breach of the socialist golden rules as an instrumentalization of the system, rather than an adoption of its validity in itself, this attitude was to cause significant problems. In the first years of Socialist Russia, there was not only an ouverte paranoia that the system instated with the revolution could be toppled but that imperial forces themselves could make a comeback if too much space was left to policies and behaviours that pertained to the old system. This belief, which later led Stalin to turn to Five Years Plans and abolish NEP, not only meant that there would be a completely alternative method of running the market but that individual initiative in ‘the capitalist form’ was a dangerous element which could not be part of the values and mechanism of society.

The experiment of NEP then was not only significant because of its results and for the interesting combination of state owned and market forms, but because its negative connotation was followed by a stark opposition to any such compromise for the decades to come. The suppression of the possibility to carry out any action for the sole motive of personal economic gain was actively suppressed, and not simply as a by-product of the command economy that was to come, but with concerted efforts to change the attitudes of society.

1.3 Soviet Russia, the Five-Year Plans

After the death of Lenin in 1924, Joseph Stalin assumed the political leadership of the USSR. Under his guidance the country’s economy began its transformation into a command economy. This specific type of economic organisation is characterised by the central role of the State, which becomes the sole responsible for conducting and regulating the whole system of production. In pure types of Command economy all the elements necessary for the production chain are under the control of the State. All raw materials and means of production, whether industrial or agricultural, are in possession of the central authority. Under this type of economic organisation of society, given that private property is non-existent, the State then is responsible of stirring the economy in a precise direction which is set through ad hoc long-term plans that regulate production and distribution of goods. These plans, which in the case of the USSR were called Five Year Plans, are a detailed set of provisions that set the amount of supply allotted to each sector of the economy and the subsequent target of production to be reached. These goals were then to be implemented by the single state-owned enterprises.

In a market economy, on the other hand, the system that regulates how much, and which goods are to be produced is driven by consumer demand to which firms then regulate their production. The indicator of consumer will, price, is necessary not only as it regulates production, but as it provides a motivation for firms, namely gain. In a system of command, this mechanism becomes obsolete as, since distribution of goods is also controlled by the State, price is fixed by the central authority and is no longer a meaningful indicator of consumer's will. The issue then becomes not only if redistribution is actually efficient and meets the needs of the population, but what are the incentives for the firm to produce.

These questions are especially relevant not only in the here and now of analysing the performance of a command economy, but especially since the prolonged existence of these mechanisms in Russia had a relevant impact when the system began giving signs of strain, prompting efforts to reform.

Russia's experience with command economy, and Five-Year Plans, lasted sixty-five years, for a total of almost thirteen plans implemented. There is a great variety both in the aims of each plan, and in the circumstances in which they were applied, with some spanning through monumental events such the Second World War, or important leadership changes, like the death of Stalin. Of all those plans though, the most relevant one is certainly the First Five-year plan, as it set the tone for the ones to come. After the death of Lenin there was a fierce debate on what should be the essence of economic planning, of which the core argument was whether it should serve to replicate market equilibrium for the benefit of all or create a system which could facilitate the achievement of significant goals at the State level.

This rather radical view, sponsored by Stalin himself, envisioned the economic system as one that could respond to quick mobilisation, requiring a strict type of control over all its elements.

The main aim of the first Five Year Plan (1928-1933), devised by the Gosplan, was to increase the development of heavy industry and collectivising agriculture. These aims reflected the radical view of a quick mobilising economy, as their success would transform Russian society, and turn the country into an industrial powerhouse that could rival counterparts in the West. To achieve such objectives, there was the need to an all-encompassing action that required, first and foremost, the collectivisation of agriculture. This policy constituted mainly in reversing the trend established with the NEP, substituting it with a system of collective farms reuniting the allotments that were previously granted for private use. This system created two institutions, the Kolkhozes and Sovkhozes, controlled respectively by the collective and by the State. These units then were compelled to sell their produce to the State for priced fixed by planners, compensating labourers either by a share of the produce or with a salary correspondent to the days of work completed.

It is important to note that the measure of collectivisation was devised with the scope to aid industrial development. The ways in which such a drastic measure could have helped industry depend on the point of view which is adopted. The first argument maintains that having larger plots of terrain with available labour force could mean that these lands could be farmed with more advanced technologies hence achieving an increased food production that could sustain industrial development in the cities, a model that would help to replicate in a short span of time what where the preconditions for industrialisation in Western Europe. The alternative view, adopted by Stalin himself, understands the need for collectivisation as the best possible way to transfer resources from the agricultural to the industrial sector. On the one hand, this transferral of resources was intended as the ability to push agricultural production to its limits, hence ensuring a sufficient food supply to the rapidly growing industrial cities. This operation was possible due to the collectivisation of agriculture, well constraint within the limits of centralised control. The additional benefit of this arrangement allowed the State, through the means of price control, to buy the produce at the lowest possible value, hence maximising the ratio between savings and quantity of purchased product. This arrangement served the State particularly well since it could also export agricultural products at a low price, increasing the funds to purchase much needed capital goods from abroad. On the other hand, collectivisation served as an efficient method to delay State investment in the agricultural sector to focus on industrial development instead. It was then envisioned that a more developed industrial sector could produce better equipment to then foster the growth of a more efficient agricultural sector (Preobrazhensky, 1965).

The efficiency of collectivisation is a topic of much discussion. It is undoubted that the policy had a disastrous effect on the peasant population, especially that of the Kulaks, subject to ouverte persecution by the regime. This dire situation, combined with the struggles of peasantry to adopt to the new system with scarce technologies available and with little incentives to produce, also caused major disruptions in food supplies, which resulted in severe periods of famine. On the other hand, though, the conditions in the countryside and the little advantages to be found in agricultural production, did indeed favour migration to the urbanised centres, creating large amounts of labour force to be employed in the fast-rising industrial sector. The positive side effect of such mobilisation was also an increase in per capita consumption by one third through the 1930s (Bergson, 1961).

The key resolution of the first Five Year Plan was, though, to spur the growth of the industrial sector, especially heavy industry. During the NEP years industrial output had returned to the levels of 1913, hereby the totality of the capital stock available in the country was at that point fully utilised. To create additional growth in the industrial sector new capital had to be created through investment or other methods. The export of agricultural produce at low prices in exchange for advanced western capital goods, mainly machinery, was one of these methods. The increase in investment, built on the shoulders of a struggling agricultural sector, was to be focused on the production of capital goods themselves, mainly steel and machinery, which could then be reintroduced into the hard industry sector again. The initial aim of Gosplan economist, such as Fel'dman, envisioned that the growth of heavy industry could then kickstart the growth of consumer goods industries, prediction that was somehow realised within a decade. This policy worked well until the 1960, in which GNP growth stayed constant at around 5%. This was due to the concomitant presence of other factors that favoured growth, which, arguably were the same that contributed to the demise of Soviet industry itself.

The core factor that explains to understand both the growth and the fall of productivity in the Soviet Union was directly linked to the centralised planning method. Until the 1960s centralised planning worked well in promoting the growth of the industrial sector because of the mechanism of production quotas. These quotas were usually out of reach, and they were seldom achieved by the end of the five-year period, still they managed to have positive effects. Each enterprise had to meet, within precise time limits, precises benchmarks on the quantity of output to be produced. These quotas could be linked to the realisation of what could be defined as either slow or fast projects. A slow project reaches its completion, and produces earnings, in a time span that requires financing once, whereas long projects may require that financing be protracted in time hereby requiring the financing institution to consider whether to renew the financing or not based on the initial return of the project (Maskin, 1995). In a situation where the economy is centralised, and the mechanism of production is fixed by quotas, the State is not only the sole responsible for financing, but it expects that even long projects will eventually bring the desired yields, since they have to comply with quota mechanisms designed by itself. The system that is in place is then one of *soft budget constraint*. In practice, firms can expect financing even when they have not reached the desired output, or better, have not reached it *yet.* Until the 1960 this configuration allowed firms to increase production, especially since it contributed to the successful increase of capital stock through the setting of high targets and contributed to the increase in employment of people that would otherwise be less productive in the countryside. (Allen, 1998).

The parable of growth of the Soviet Union, though, reached an impasse from the 1970s onwards with GNP growth quickly declining form a 5% increase to only a 2% increase in the 1980s. The factors that explain this declined are also linked to the institution of central planning of which negative effects combined with concomitant factors. In a situation in which, as mentioned before, the system works by a soft budget constraint, firms are subject to two biases. The first, *quantity drive,* implies that if the system functions by setting precise targets for production, and if these targets are high, firms are driven to request the central authority amounts of materials exceeding those necessary for production. In a command system, which is resource constrained, this process can severely impair the capacity to supply all industries with the requested materials, thereby creating debilitating shortages in the consumer goods as in the in the one of capital goods. In the Soviet Union, given that meeting production targets resulted to bonuses for managers, the problem was especially plaguing since every enterprise was motivated to grow, possibility that was best achieved by ensuring having the necessary goods for production. The second bias, *investment money illusion*, pertains to the expectation of the State that their investment would yield returns. This prompt firms to expect that they would be protected from the possibility of insolvency. The combination of these two biases, already difficult to maintain in the long term was coupled to additional factors (Kornai, 1979).

First of all, the Soviet administrators, faced by the necessity of keeping the GNP growth positive, resolved in improving industries and machines already existent, rather than investing in creating more technically advanced ones. This choice was motivated mainly by the additional cost and by the temporary interruption of production associated with modernising machinery (Popov, 2002). This type of investment was largely wasted since, not only the creation of additional capital in old industries leads oftentimes to lower returns, but especially since Russia had low levels of returns to capital. The elasticity of substitution between one unit of labour and one unit of capital was, in fact, extremely low. During the period of economic growth, investment allowed to increase the number of industrial workers employed, which in turn contributed to the rise in production. Once the labour force was exhausted, the State hoped to continue the growth trend by investing in increasing the amount of capital goods, as it effectively had before. The problem was that the elasticity of substitution between capital and labour was at an all-time low, a predicted 0.4, meaning that being virtually all the people employed, the increase of a unit of capital led to visibly diminishing returns. (Weitzman, 1970).

The already dire situation was worsened by the arms race of the sixties, which not only swallowed almost 12% of the budget, but also concentrated most of the efforts of resource and development which were diverted from the industrial and commercial sector. Military technologies, through most of the western countries, could then be applied to civilian industries through *spill over* from the military to the civilian sector. This process famously introduced technologies such as the computer or satellites in the civilian market resulting in significant development in the non-military industry. In the Soviet Union the spill over process was significantly delayed, with innovations developed for the military being transferred to the civilian market when they already had become almost obsolete, and hence no longer considered a military prerogative. This mechanism effectively wasted the investment in the military industry as it deprived it from transferring it indirectly to civilian industry. (Amman and Cooper, 1982).

The period between the 1970s and 1980s also saw the emergence of another factor that would overtime weaken the economic standing of the USSR, the change in the terms of the trade balance. Through the 1960s, owing to collectivisation, the USSR was one of the main exporters of grain and agricultural products. With the growth of the industrial sector, and the migration of labour force form countryside to city, urban population began to grow, necessitating an increased amounts of food supplies and other goods, such as meat and consumer's goods. By the 1970s the agricultural sector was plagued by heavy disfunctions, deriving mainly from the fact that the price paid by the State for agricultural products had not increased in time, creating a prolonged situation of lack of incentive and investment. By this time then, Russia's countryside was not able to produce the yields necessary to sustain the needs of the population. This scenario resulted in the USSR beginning to import its food supplies from abroad, becoming the main importer of grain products in the world through the 1970s. This rise in agricultural imports went hand in hand with the increased necessity to import technologically advanced capital goods and consumer goods that Soviet industry was not able to produce domestically, so to hopefully maintain the standard of life of the population and increase the productivity of industry. The import side of the trade balance then was constituted by goods of primary importance which could not be in any way reduced or replaced and were fundamental for the maintenance of subsistence in the USSR. This system somehow worked well during the

1970's, a decade pervaded by oil supply crises, which saw Russia increasing the quantity of oil and raw materials exported. This strategy paid off as prices for energy goods were high during the decade and development of the energy industry was able to draw in investment for Western Countries, allowing for the accumulation of sovereign currency.

This system though, was lucrative only if the prices of oil and gas remained high, scenario that changed dramatically at the cusp of the 1980s. The value of Russia's main exports then decreased dramatically, making it harder and harder to sustain the previous trade balance, especially since by that time exports constituted 20% of the Country's economy. The roots of Russia's dependence on the energy sector became evident at the time as, deprived of this source of revenue and with the rise of import prices, there was no other choice other than reducing the amount of goods imported, creating even more debilitating shortages.

The concomitance of all the aforementioned factors meant that already during the 1980s there was an apparent necessity to introduce a change in how economic relations where run in the country. It appeared that the method of central planning was not only able to control the economic system but that it had reached its potential in answering the pressing questions on how to remove the Country from the unfavourable position in which it stood.

1.4 The Perestroika

By the 1980s given the afore detailed challenges which the economic system was facing, the question of how, and in which way, the economy could be reverted to the trend of growth emerged. The issue of how to achieve growth was, at this point in time, radically different than what it had been during the Stalinist (1924-1953) and Khrushchev (1953-1964) eras. By the time of Brezhnev's leadership (1964-1982) the issue of growth was in fact complicated by the concomitant necessity of modernisation. During the first years of the Soviet system the 'sufficient' element to increase growth was primarily the maximisation of the use of available untapped resources of capital. Such aim could be successfully achieved through extensive investments plan that helped mobilise both resources and labour. This action, guided by the rigorous structure of Five-Year Plans effectively worked in achieving the desired aim. By the 1970s and 1980s, though, the capital available was almost fully utilised and the necessity for alternative ways to achieve growth came to light. In this setting, the focus shifts on how to achieve better productivity of labour and capital. This objective become increasingly important not only in maintaining the tenure of the already existing industries but in fostering the growth of the consumer industry, which in a society that had now become industrial, are crucially needed to keep up with consumer demand.

This challenge proved to be especially difficult to tackle by the Soviet leadership for a variety of reasons. First of all, the Soviet centralised system was characterised by *fusion* (Valerie Bunce, 1983), that meant that the political and economic elite were more or less operating in the same sphere of action, where all resources where concentrated. The balancing of economic interest by various interest groups then become linked with economic stability, making it very arduous to achieve reform without destabilising the political stability of the State. As a direct result of this specific configuration, and as the economic system became more complex, the late Soviet leadership, especially Brezhnev, tried to devise a system which could maintain this delicate equilibrium in place. The organisation of the system during this period hence turned towards the corporativist mode, which aimed mainly at channelling different lobbying interests in an institutionalised way. Corporativist organisation of the elites was paired with the effort to address the situation of the working class. This stratum of the population was fundamental to political stability and, by this point, stark focus of attention due to the necessity of improving labour productivity. The way in which such aims were to be achieved was believed to be, at least in Brezhnev times, to lock workers into a social contract that would see the State maintaining high level of welfare in exchange for consensus and collaboration (Cook, 1992). This configuration of society, and ultimately economy, constructed to maintain a certain level of stability, was hoped to be a solid base to achieve the economic reforms necessary to put Russia back on track.

This assumption proved to be wrong as during the 1970s it clearly appeared that the necessary reforms to reinstate the growth of the economy were all but compatible with the stability achieved through the corporativist system. The plaguing necessity of modernising Russia were in fact tied to issues regarding technology and, most importantly, labour productivity. It proved especially hard to devise economic reforms in this direction, although many attempts were engineered through the 1970s. Interestingly, most of these efforts aimed at seeking incentives for firm production centred mainly on replacing the requisite of quantity with that of sales and profitability. The mechanism of investment and supply was also modified to try and shift responsibility on the firm. In terms of labour productivity, targets were to be reached by managers in exchange for bonuses, with the same system devised to achieve better product quality. Despite the efforts of these reforms, which essentially tried to simulate market incentives, the situation in the late 1970s and 1980s, as detailed above, continued to deteriorate with a constant fall in growth and raising budgetary struggles.

The obvious difficulty of the Soviet leadership in formulating a strategy for economic recovery was linked to a secondary element that had a significant influence on the prospects of devising an effective reform plan. Faith in the planning system was the primary premise of economic thought in Soviet Russia. This economic organization structure was never questioned for its efficiency in mobilizing resources, with the astounding boom of the 1930s acting as the most visible example of its soundness. The Stalinist notion that central planning was the best way to accomplish substantial changes in the country's economic direction was never truly questioned until the late 1980s. The primary focus of reform ideas was how to introduce new economic incentives on top of the conventional structure of the economy. (Mau, 2007).

When Gorbachev became General Secretary of the Communist Party in 1985, he knew he needed to formulate a plan to reform the economic system. However, in this effort, he was constrained by the two aforementioned constraints: an inherited system centred on maintaining the Soviet Union's delicate stability, and a model for change that gave a spectrum of action that was confined in its horizons to retaining the basic institution of planning. The initial characteristics of Perestroika, referring to the reform program in its entirety, should have been built as a system that could coexist with the issue of stability and the possibility of retaining central planning. The main aim of the plan in its initial stages was also consistent with the traditional socialist logic, as it was envisioned principally as a set of means to achieve ‘better welfare for the people’ an objective which, in all fairness, persisted to its last days.

The course of action at this point was focused on augmenting productivity, and on the ‘improvement of economic mechanism’. The first goal, also called acceleration or *uskorenyie,* was to be achieved through centralised planning, as it consisted mainly in a shift of investments to machine making industry, necessary to increase the production potential of Soviet factories and boost the capacities of the consumer goods sector. This element integrated perfectly into the already existing mechanism of interest at the political and economic level, since it did not fundamentally interfere with particular lobbying interests.

The second question, how to enhance society's economic system, was significantly more complex and presented obstacles that evolved over time. The core of the problem is primarily related to production incentives, both for the individual worker and for the firm. The creation of such a quandary had its origins not in the 1980s, but in the 1960s, under Khrushchev's leadership. As he went through the destalinisation process, it became clear that the late dictator's iron discipline had a favourable effect on labour productivity, establishing an incentive relying on terror. The Khrushchev era, when the countryside's labour pool began to dry up, coincided with the first attempts to reform the economic system in order to develop extra motives that could boost labour productivity. These changes were inherently inefficient and relatively short-lived, but they represented the first attempt to design a system that could replace the effect of unemployment and social competition on labour discipline in capitalist systems. (Garegnani et al. 2002).

By the time of Gorbachev, the incentive problem had persisted and was in even greater need of a solution. Still, it was anticipated that the issue might be resolved by retaining the institution of state ownership as well as control over the price system. The goal was to progressively offer more autonomy to businesses while keeping the aforementioned constraints in mind. According to these standards, Gorbachev's ultimate programme was significantly more radical. Individuals' ability to sell self-produced items was restored by the Law on Individual Labour in 1986. This tendency was followed by a series of even more destabilising measures in the years that followed.

The Law on State Enterprises (1997) was the first significant challenger to the old Soviet structure. According to this regulation, Five Year Plans were to be viewed as an indicator rather than a formal programme, and the production guide was to be based on a value target rather than a quantity target. To generate incentives for production, the state abandoned the order mechanism and replaced it with a contract system, resulting in only a portion of the firm's output being acquired by the central authority. The remainder of the production might then be differentiated and sold to autonomously selected buyers at a price established within a range by the firm itself. With this reform, control of pricing was in fact left intact only on basic goods such as energy and raw materials. The ability to set prices within a certain markup should have served as a double incentive as the system of firm financing was also reformed to allow profits to play a part in the balance of the enterprise, which should then be motivated to devise ways to modernise autonomously. This program though did not go to plan as the structure of State enterprises was not constructed in an adequate way to channel resources effectively. The institution of self-management of workers, which paired with the possibility of gain was meant to increase labour output, diverted most of the resources earned into a rise of salaries without any substantial variation to quality and amount of production (Kotz, 2007).

The problem of quality and availability of output was in fact substantially worsened as the ability to set prices, in a system in which market competition had not been standard practice and in which shortages were frequent, resulted mainly in unmotivated markups of goods that only had slight improvements in respect to those previously in circulation. The increased prices of these goods, mainly consumer ones, meant that they were out of reach for the majority of the population, creating an overall worsening of shortages. To circle the problem the institution of the black market became widespread, offering basic goods for prices even higher than those set autonomously by enterprises (Smith, 1993)

Such situation was worsened by the unexpected development of Cooperatives. The Law on Cooperatives (1988) allowed for the formation of business associations between privates in a differentiated range of sectors, from manufacture to industry. These newly created entities could also participate in joint ventures, meaning coordinating the action of more cooperatives. This category was virtually exempt from all mechanism of control of the central economy, from planning to price control. They could furthermore engage in credit activity, privately hire labour and sell their means of production. Due to the favourable set of conditions the phenomenon of cooperatives ballooned, with approximately three million of these entities created within one year of the enactment of the Law. The problems of cooperatives was, though, not their characteristics in itself but the way in which they operated. Many Soviet managers used this tool to buy goods from their own State enterprise, process it in the cooperative with negligeable results, and resell it into the market without any markup or price constraint.

The increase of entities able to produce goods to the market at a variety of different prices thus increased dramatically in a short amount of time, without generating any of the benefits necessary to the economy and plunging a previously unproductive, but orderly system, into chaos. The variety of the goods sold and their quality was not at all improved as the whole system was at this point concentrated on extracting the maximum possible profit form resources and technologies already existing. To be fair, the possibility of organising production in a more orderly manner was nearly impossible at this point in time because the system of supply of capital goods and resources was in absolute chaos due to the retreat of State authority and, it too, plagued by shortages.

All of these issues were exacerbated by the December 1988 directive "On the Foreign Trade Activity of State, Cooperative, and Other Enterprises." By passing this statute, the state relinquished its monopoly on foreign trade and permitted other entities to participate. The main beneficiaries of the reform were once again cooperatives, which could now have the resources to buy vast amounts of natural resources at prices that were still controlled by the State, a pricing system that was still in place so to avoid significant disruption of supply. These resources were subsequently sold privately on foreign markets at higher prices, resulting in great profits for cooperative owners, but furthering confusion in domestic markets, as resources required for manufacturing were now being siphoned out of the country and out of the production chain (Gustafson, 1999). This action had an additional negative side effect in that it pushed the already precarious Soviet trade balance even further into peril, as external forces could now compete with the State in conducting foreign trade, a complication that was especially unnecessary given that oil prices had been steadily declining throughout the decade.

The state of disarray, which had become pervasive in the economy, was exacerbated by the fact that it could now be openly addressed, and people could publicly grieve the loss of the stability they had enjoyed under the Brezhnev social contract era. This open loss of confidence and broad disagreement with Gorbachev's leadership was the unintended consequence of a policy designed to promote Perestroika. Glasnost, which translates as transparency, was a program that began in 1986 with the dual goal of involving citizens in the process of economic resuscitation by mobilizing the social component of production and reducing internal party resistance by open discussion of reform efforts. Neither of the basic goals was realized, as the Glasnost system was the one that finally jeopardized the inefficient, but stable, system of corporativism. The variety of interests that developed with the ability to manifest them in the first place was far too great to be absorbed properly by a system that had been completely isolated in its workings up to this point. Furthermore, despite being warmly regarded in the West as an indication of a prospective interest in democratisation, Glasnost contributed to the ruling class’s split, with 'old school communist' now openly clashing with Gorbachev's leadership. This institutional chaos eventually favoured the emergence of new forces, such as the figure of Yeltsin, which ultimately contributed to the demise of the Soviet Union.

The whole parabola of Perestroika has been the topic of endless discussion. Some have argued that Gorbachev embarked in a program of reforms without a coherent plan, rather reacting to the snowballing effects of each law as they were passed (Clarke, 2007), while others have maintained that the program of reforms had taken forced and inevitable deviations from its original configuration due to the sheer complexity of the problems of the late Soviet Union (Mau, 2007). What is out of discussion is that many of the difficulties and dysfunctional developments that incurred after the fall of the Soviet Union in 1991 had their roots in the chaotic period of the Perestroika Years.

Chapter two

2.1 The last years of the Soviet Union: the 500-day plan

In 1990 and 1991 Soviet, and Russian, economy was in dire straits. At this point the impact of the Perestroika reforms was irreversible and had led to a situation of chaos. The gravity of the panorama then called for an evolution in the system devised to revitalise the economy. It is at this point in time, after the realisation that the planned economy could in no way be reformed as hoped, when the intention to turn Russia into a market economy materialised as a real possibility. The question of the validity and feasibility of this scenario was, though, shrouded by intense doubts.

The scenario that made the institution of a market economy seem like the sole route available was mainly linked to the dire consequences of hyperinflation, combined with the progressive break-up of the Soviet Union. The prerequisites for the creation of hyperinflation lie in a different set of variables inextricably tied to the steady demise of Soviet economy.

First of all, by the end of the Perestroika years the main difficulty of the Soviet State was one of obtaining revenues. The liberalisation of the organisation of production meant that the Centre was deprived of tax revenues that were traditionally controlled, and an integrating part, of the mechanism of planning. Furthermore, the taxes that could be extracted from enterprises under the new system were also significantly lower due to the steady fall of productivity during the late 1990s. The internal situation was compounded by decreasing prices of energy products and an increasing worsening in the trade balance, which plunged the country further int budgetary hardship. The loosening of the centre’s control and the increasing autonomy of Soviet Republics created an additional difficulty, as the unwillingness to transfer revenues from the rest of the Union to the Centre became widespread, furtherly reducing the capacity of State budget. The accumulation of these factors contributed to render efforts to cut government spending, a target set at minus 20% in 1987, completely ineffective. By this point budget deficit had reached an alarming 20%. The response of the Gosbank, the centralised and only bank of the Soviet Union, was to cover the deficit by increasing the amount of money in circulation. The system held up until prices remained fixed by the State as the increased amount of currency introduced into the system did not result in an increase of inflation. Once prices started to rise after the reform of Perestroika, albeit being set within a certain limit, the problem of inflation started to spiral.

Despite the increase in prices, due to the lack of a proper demand driven system, production failed to grow accordingly, hereby creating a situation in which rapidly rising inflation was not met with an increase in production output. On the other hand, Gorbachev’s reforms managed to achieve an increase in workers’ wages, deriving from the greater degree of freedom accorded to managers. The concomitant persistence of shortages resulted in the growth in wages being channelled in deposits and savings. The large amount of money withheld in this manner created a potential time bomb as, if prices were to be risen, this substantial amount of liquidity would have compounded the money influx provided by the central bank and contributed to spiralling inflation. The question of ‘freeing prices’ namely allowing prices to be set through the demand driven market system would have posed a significant challenge as it would have most certainly resulted in increases so rapid to generate the phenomenon of hyperinflation, characterised by significant daily increases of price levels. The issue of pricing then became the most pressing one in the optic of introducing a new round of market-oriented reforms, but one of the most difficult to tackle without generating an overwhelming burden on the population. The leadership of Gorbachev then was faced with the necessity of introducing these reforms, but had to withstand a series of quickly worsening economic circumstances that would render the engineering of any proposal in this regard extremely difficult to balance in terms of population welfare.

The main obstacle towards the realisation of such reform plan, though, was mainly the destabilising political situation of the country. By 1990 it was clear that the Soviet Union was bound for dissolution, with national movements raging through the Soviet Republics, a direct result of the liberalisation promoted with Glasnost. The situation in Moscow, and in the Russian Republic was also confused. By the late 1990s the figure of Gorbachev was antagonised within the Communist party itself, with many of the long governing political class opposing any type of further reforms. This scenario was significantly worsened in terms of political stability by the emergence of the figure of Boris Yeltsin, a politician firmly in favour of the issue of Russian sovereignty, but more importantly, directly elected as President of the Russian Republic in 1990 through the first democratic election of the country, premise that could not be applied to the figure of Gorbachev.

At this point two powerful political forces were present in Moscow, Gorbachev, still head of the USSR and nominally possessing the power to initiate reform, and Boris Yeltsin, now a force to be reckoned with in the decisional process. The conflict between the two, and the necessity for further economic reforms resulted in the first attempt to introduce a clearly defined market configuration of Russia's economy. This attempt materialised in the redaction of the 500-day plan. The staunchest promoter of the plan was Yeltsin itself who was, by this point, pressing Gorbachev on his inability to decide on the course towards market economy. The President of the Soviet Union then tasked his Prime Minister, Ryzkhov, with elaborating a strategy to turn Russia's economy into a market one in 500 days. This task was to be achieved with the collaboration of advisors from Yeltsin team, who should have operated with Gorbachev's in the so called Shatalin Commission. In the end the two groups devised two programs with the shared aims of achieving privatisation, stabilising money supply, increasing prices, reducing debt, creating a sound market for commodities and sound financial institutions. At this point in time though, the chance to achieve these drastic goals, let alone in 500 days, was a matter of political stability, even more that it was of economic necessity. In Ryzkhov's understanding of the implementation of the plan, reforming efforts should have begun with rapid price increases, necessary for economic stabilisation but undoubtedly unpleasant for the population. The view of the Shatalin Commission was that, given the need for popular support of the reforms, the plan should have begun with an intense effort to privatise. In the end, albeit Gorbachev having started to initiate reforms in the direction of the market through the mean of presidential decrees, this effort was stalled by the ongoing political turmoil and ultimately, by the breakup of the Soviet Union.

The ultimate demise of the Soviet system and of Gorbachev's leadership was in fact a consequence of the disappearance of the Soviet Union as it was. By 1991 several of the Soviet Republics had stated their will to declare national independence, with the Baltic States at the forefront of the movement. The last attempt to resolve the situation and maintain the 'Soviet entity' was to reorganise the Republics in a federation of states under the New Treaty of the Union, creating a sovereignty arrangement on the model of the European Union. This plan, endorsed by Gorbachev, found heavy opposition in the hardliner faction of the Communist party, opposition which ultimately ended in the coup of August 1991. Despite the failed effort to reinstate the predominance of the Communist party and Gorbachev being reinstated in his role as President, the episode was the final straw in the maintenance of power firmly in control of the Centre. At this point in time the Republics had manifested their unwavering will of becoming independent, and within Russia itself the leadership of Yeltsin had now completely replaced the one of Gorbachev, leaving his role as president of the USSR completely devoid of meaning. In fact, the factual breakdown of the Soviet Union, engineered by the leaders of Russia Ukraine and Belarus on the 8th of December, did not involve the leadership of the USSR at all. The Belaveža pact resulted in the gradual emancipation of the Republics, with Russia breaking apart on the 12th of December 1991 under the presidency of Boris Yeltsin. The official end of the USSR though, ensued on the 25th of December of 1991, with the dismissions of Gorbachev and the Supreme Soviet ratifying the decision the next day. By the beginning of 1992 the Soviet Union had disappeared. Yeltsin was at this point the President of the newly constituted Russian Federation and was tasked with the duty of reforming the economic system.

2.2 1992 and the issue of economic reform

Executing the transition from planned economy, or what remained of it by 1992, to market economy in Russia has certainly been one of the most thought of problems of our century. For any government attempting to realize such aim and fundamentally restructure the economic mechanism of a country, the starting conditions and possible plans of action are fundamental to consider. With the question of whether to transition to a market economy settled, the debate opens on how to carry out such process. The case of Russia in particular presented itself as a complex one, not only for the political charge of the transition, but for the economic past of the country that was, unlike 'classic' development economies, well rooted in the tradition of command, with the subsequent corollary of societal attitudes and institutions that came with it. Transitioning then, not only implied that the measures aimed at stabilizing and kickstarting the economy were workable and efficient, but mostly that the newly constructed system was engineered in a way that allowed for the institution of the market to thrive in the future. This task was especially delicate since it implied a complete restructuring of the whole system, from strictly economic issues, such as property or fiscal and monetary policy, but also of the attitudes of society towards their role in economic production, the creation of an efficient legal system and the achievement of the hopefully long-term institution of democracy. Given these necessities the task of the reformers was especially cumbersome and riddled with the issue of which reforms, in which order, and with which speed, should be implemented to achieve a transition that could be deemed somehow successful.

The possible paths to follow in reforming the economy, and the beliefs upon which they were based, were certainly dependent on the general orientation of economic theory in the 1990s. By this point in time there was a strong belief that a precise set of reforms, known as the Washington Consensus, was the ideal formula to tackle the issue of developing economies. The core theoretical principles at the basis of this reforms were based on the principles of neoliberalism, with a marked pro market stance and a precise modus operandi focused on the abolition of all barriers to the workings of the latter. This paradigm of the necessary path of reforms emerged from recent experience in South American countries facing development, such as Chile and Bolivia, a process engineered with the strong participation of the United States, particularly the Treasury, and other institutions governed by neoliberal economic principles and also heavily influenced by the American power, such as the World Bank and the International Monetary Fund. These three actors, with the collaboration of a series of experts from the most influential universities in the United States, most notably from the Harvard Institute for International Development, also had a heavy influence on economic reform in Russia.

The key role of these external actors derived not only from clear political interests of the United States, which aimed at reconstructing Russia in a way that eliminated the threat that it posed internationally, but also from the historical difficulty of producing expert reformist within Russia itself. By 1992 most of the economists of the country were not only technically unprepared to initiate the task of reform but also came from a system which traditionally envisioned their collaboration as being restricted to the Gosplan, the centralized planning agency. The issue with the system, and the general structuring of the USSR in general, meant that the class of economic advisors had seldom to deal with the political implications of their reforms, or with the necessity to generate intragovernmental approval for them, let alone getting the population on board with the reform plan. The role of the numerous advisors and external organization was then not only to help engineering the reforms itself, but also direct the difficult collimation of the economic and political spheres in a democratic setting, in which Russia had no experience whatsoever. This process was fraught with its own difficulties for a series of factors that arguably worsened the reform process in Russia as not only was the democratic government feeble and fraught with conflict, but the political tradition of leaders such as Yeltsin oftentimes prevented them from understanding the necessary action to be undertaken at the government level to ensure an orderly advancement of the plan.

To return to the issue of the content of the reform, it is apt to begin with the provisions envisioned by John Williamson (1989), the Washington Consensus. The ten key point dictate as follows. The fiscal policy of a country should be strict, so to avoid disproportionate amounts of deficit, the expenditures of the State should include as little as possible unnecessary subsidies and rather focus on health, education and public investments. Taxation should have an increased base, but low tax rates. Interest rates would ideally be determined by the market, and possibly remain positive, and the same principles would apply to exchange rates. External markets should be left open, with minimal tariffs and no quantitative restraints, FDI should also take a role in the country's economy, albeit not a key one. Lastly, privatization of State assets should be considered a priority, and so deregulation of competition within the market. To sustain these two points rights of private property should be duly protected.

These steps were more or less shared by the majority of economists that came to be involved in Russia's transition, albeit with a fundamental distinction between two groups. The main point of contention was tied to the speed and order with which reforms ought to be implemented. Experts were divided between two main approaches, the gradualist one and the 'Big Bang' one, also known as shock therapy (Sachs). The latter was designed by three main economists David Lipton, Jeffrey Sachs and Leszek Balcerowicz, who all experienced firsthand with reform efforts in a variety of regions, from South America to Eastern Europe (Poland being the most prominent case). The general theory emphasized the necessity to conduct all the aforementioned reforms at the same time and in the shortest time possible, a task that was not only deemed entirely feasible, but the best possible option to avoid reforms to be complicated by the reemergence of unfavorable conditions, especially relative to the loss of political momentum (Åslund, 1994). Still, despite agreeing on the basic validity of this principle, the issue of whether this approach was the best alternative for all post-Soviet countries was a concern within the shock therapists' field itself. Some experts, such as Klaus (1993), argued that there was a need to establish whether the preconditions for shock therapy were present before implementing the reforms, with a particular focus on the readiness of the government to carry out a coherent program from start to finish and the attitude of the broader population towards the institution of the market. The preoccupation on the preconditions for reforms specifically was the main argument for the gradualist field. The plan of action in this case was to implement reforms within a distance from one another, in a gradual fashion, so to ensure that both the institutions, the population and the enterprises had time to adapt to them before introducing the next step. In this conception of the reform path, it was emphasized that for the institution of the market economy, the institutional and legal pillars that would sustain it had to be present before drastic reforms such as privatization could be implemented (Stiglitz, 2002). It was also considered of fundamental importance that the government retained a special attention in maintaining social programs, such as health and education, to avoid a slump in the welfare of the population that would most likely follow the effort of liberalization.

Shock therapists disagreed with gradualists on the last point, and on the role of the State, due to the effects they envisioned market reforms would have of the totality of the system. Shock therapists, as neoliberal economists, held a strong confidence in the primacy of economic transformation, anticipating that once the market mechanism was in motion, other substantial changes in institutions and society would follow. They did recognize, though, that the first round of reforms would result in a slump in GDP and general conditions of the population but were firm believers that the path of the economy would follow somewhat of a ‘U-shape’ course, with a recession to be swiftly followed by recovery. Because of this assumption, and to allow this fast change to happen, the focus of their proposed transition solution was not on establishing a cautious path of development in all domains, but rather on eliminating all potential barriers to the inherent workings and impulses of market mechanisms.

In engineering the reform, and in offering their assistance to the Russians, shock therapists focused less on ensuring that the state of the newly born democracy withstood the difficulties of implementing such a comprehensive reform strategy, and that there was an apt legal structure to support the institution of the market. Shock therapists also underestimated the role years of life under the command economy had on the expectations and attitudes of the Russian population. The theoretical base for interpreting the economic behavior of the individual was mainly constructed around the assumption that the incentive of gain would be sufficient for a whole population used to the way of command to understand how to behave in a market setting. This assumption also related to the expectations on the level of welfare, and generally the role of the State in providing it. Since Soviet times citizens developed the expectation of universal welfare, which in their conception would be maintained by the State. It was then difficult to expect that the average citizen would have the ability to quickly adapt to the new market system, and to the reduced role of the State envisioned in it by shock therapists.

These inadequacies of the 'Big Bang' reform approach, however, were not a distinguishing factor in ruling out the adoption of a rapid and concurrent rollout of changes in the 1990s due to a variety of variables. To begin with, Russia, like all of the former Soviet Republics, was in such macroeconomic disarray that any kind of reorganization was impossible to envision without instituting dramatic reforms to provide the groundwork for market evolution. In this case, the gradualist approach could have resulted in a complex scenario, similar to that established by Perestroika. Given Gorbachev's efforts to introduce halfway reforms, it was thought unlikely that initiating the market revolution gradually would have resulted in any less instability. The path of a gradual reform introduction was also, especially in the case of Russia, precluded by the size of the country itself. Introducing reforms at a slower pace, or implementing trials, would have had a detrimental impact on the ability to carry out a smooth transition since regional entities in Russia enjoyed a great level of independence and were difficult to control from the center. Most of these problems were ultimately tackled by shock therapy in any better way than gradualism could possibly have had, but nonetheless were a sufficient factor to sustain the imposition of a fast wave of reforms.

2.3 Russia's reform path to market economy

In 1992, under the leadership of Boris Yeltsin, Russia undertook the first steps toward the institution of a proper market economy. The project over which reforms were constructed followed the approach of shock therapy, with many prominent exponents of the theory, such as Jefferey Sachs, advising the Russian government. Alongst academic experts, personnel from the IMF and the Treasury also participated in the efforts of transition. The Russian government itself, and the Yeltsin appointees, were also onboard with the proposed solutions with figures such as Yegor Gaydar, an economist that covered the role of Prime Minister in 1992, tasked to engineer the reform plan.

The question of why the Russian leadership itself embraced with open arms the medicine of shock therapy is certainly one to be asked. Amongst the most prominent reasons that may have motivated the decision, is the pressure on Yeltsin to deliver on the change he had promised to the Russian electorate in 1990. The support that the managed to gain within the population was in fact mainly based on the complaints against Gorbachev's ability to address the need for market reforms of which Russians were apparently eager. This pressure to deliver was evident also in the modalities with which the reforms were carried out, with the majority of them being implemented by presidential decree. The decision to undertake shock therapy was also sustained by the evidence of the recovery, albeit imperfect, of Poland. A fast slew of reforms was implemented in a country also emerging from the ruins of the planned economy, with seemingly efficient results. This observation was especially encouraging since the State also had a plaguing problem of inflation which was tackled somehow efficiently by the reforms. This problem was also present in Russia, and arguably it was the one in the most urgent need for a solution. It seems only logical then that Yeltsin and its advisors hoped that the same results could be achieved in their own country, a belief that was firmly sustained by Western advisors, many of which had been involved in Poland directly.

2.3.1 Stabilization

With the "Big Bang" approach in mind, then, the goals of the Russian administration involved the following steps to revolutionize the economy of the State. The main aim was to achieve macroeconomic stabilization of the country. To do so the most necessary reform was to liberalize prices, omitting the State from preventing market dynamics to set them. Credit should also be tightly controlled, meaning that interest rates should be kept positive and that the mechanism for awarding it should focus on enterprises that have chances for profit. Hopefully, this mechanism would have allowed to introduce a hard budget constraint, the same one present in demand constrained economies, allegedly promoting market behavior of firms. This effort should also have been collimated by the reduction of the country's budget deficit, of which 20% was spent on State subsidies for enterprises and on the extensive welfare for the population. Monetary policy would also have to be restructured, with special attention on reinforcing the Ruble *vis-à-vis* foreign currency, so to achieve convertibility. Monetary and financial stabilization should also be accompanied by a reform of the legal system and, most importantly, by privatization.

On the 2nd of January 1992 the transformation to a market economy was kickstarted by the coming into force of the Decree Liberalizing Prices. This move, on top of being the first logical step to undertake the removal of non-market mechanisms, was necessary to eliminate the crippling shortages that were affecting every sector of the economy. The reformers, especially Gaydar, understood that freeing prices would have worsened the problem of inflation, one that was already suspected to be much graver than what it appeared. Still, in light of the necessity to liberalize prices it was considered that the rough consequences of the reforms would be necessary to avoid another problem, the one of covert inflation, deriving from the substantial number of transactions carried out in the black market.

As feared, within the first months of price liberalization, inflation reached quadruple digits, with peaks of 2,508.8%. The substantial hyperinflation consequently wiped out the savings of most Russians, accumulated during the previous years of shortages, abundance of liquidity and increased salaries. Such high rates of inflation annulled the positive consequences of reducing shortages since the majority of goods were priced at such a high level, due to the scarce supply, that they were rendered substantially unaffordable to the population. Furthermore, the price increases, that interested the whole supply line of production, also had a significant impact on the balance sheet of enterprises, that responded mainly by withholding wages. (Desai and Idson, 2000). The real value of the Ruble plummeted as a consequence, downfall that was in no way compensated by an increased in salaries, plunging most of Russia's population in a situation of indigency. Maintaining subsidies to aid the population in the difficult transition was in fact ruled out as an option by the leadership, which was firmly convinced that amongst the real causes of hyperinflation there was an unnecessary high level of salaries, which could not be maintained, according to the logic of labor policy under market systems. Furthermore, in the optic of stabilization, cutting the State budget was considered a fundamental step to be undertaken, which mean that additional subsidies were definitely out of the question.

What worsened the already dreadful impact of price liberalization was the concomitant effort of macroeconomic stabilization, the other pillar of shock therapy and one of the most painful reform initiatives. The main aim of such stabilization, especially in the first years of reform, was of substantially reducing widespread inflation whilst restructuring the entire financial and monetary systems. Both monetary and fiscal policies were to be subject to contraction, which had to be implemented alongside legal reforms, such as bankruptcy legislations, the reform of the tax system and of the banking one. All these elements proved especially difficult to change in Russia. The first step to be undertaken was the drastic reduction in State subsidies and expenditures, so to balance the budget. This measure was also conceived to have an important effect on the inflationary pressure, as the wide expenses of the State budget side were, as previously seen, financed through the issuing of money by the Central Bank. The level of domestic financing of the budget was cut to about 2% of the GDP within the first half of 1992. (Lipton et al., 1992). The second move in the direction of reduced deficit was to cut the funds allocated to sectors which accounted for unnecessary expenditures; the defense sector in

Russia, for example, was subject to budgetary cuts of approximately 70% within the first four months of 1992 (Gaydar,1995). On the other hand, subsidies were also subject to reduction. The main subsidies granted by the Russian State were primarily linked to issues of price control, financing of enterprises through state orders, and general aides granted to the population and the regions. The expenditures related to the price system were eliminated by the freeing of prices, whilst the other state subsidies were cut.

According to IMF and World bank logic, social programs ranging from healthcare to entertainment, which were subsidized by the State in Soviet Times, had to convert to self-funding, or at least to a mixed system. In the case of healthcare, by any means considered a fundamental service to be offered in any modern-day State, the system that was set in place revolved around partial tax-funding and compulsory medical insurance. Arguably, this system resulted in a cumbersome structure that ultimately put healthcare out of the reach of a vast chunk of the population. This example serves well to describe a situation that constituted one of the most significant downturns of transition, namely the massive retreat of the State in areas in which it had been the main provider for almost 70 years. Albeit economically convenient, this abrupt change in attitudes had a drastic impact on the well-being and morale of the Russian population. Such attitude can be summarized by this statement of an interviewed economist of the Russian Academy of Science (Moscow, September 1992 as cited by Michel Chossudovsky, 1993): “Under the Communist system, our standard of living was never very high. But everybody was employed and basic human needs and social services, although second rate by western standards, were free and available, but now social conditions in Russia are similar to. those in the third word”.

Despite the drastic cuts in subsidies, amounting at 14% of the GDP in 1992 and furtherly decreased to 7% in 1993 (Marrese et alia, 1995), the greatest difficulty in balancing the budget revolved around the issue of monetary policy. Primarily, the critical point of the latter revolved mainly around the issue of bank credit. The first measures to try and control the banking sector was to increase the reserve requirements of banks and their refinancing rate, also a critical step in introducing hard budget constraints. These measures served well to curb inflation, which was back at 24.70% at the beginning of 1993, but the main difficulty related to monetary policy persisted, as it was tied to the attitude adopted by the Gosbank. The importance of the central bank is undoubted in every state, but in the case of Russia ever more so. The centralized and state owned Gosbank, was the sole banking institution in Soviet times and hence the one tasked with issuing credit to enterprises. Private banking and credit institutions had partially emerged after Perestroika, but the majority of credit issued was still tied to what remained of the centralized system, and hence dependent on the Central bank. The latter had adopted a strategy that relied heavily on issuing large amounts of Ruble credits to enterprises. The plan of the reformers was to cut out as much of this financing as possible hoping that the change would have spurred enterprises, both State ones and not, to finance themselves and to invest their inventory into production, hence reducing the issue of stock piling. The reduction of Ruble credit would have also helped to furtherly reduce inflation, by effectively lowering the amount of currency issued through loans. This meant that to achieve a comprehensive monetary policy it was necessary to have the Central Bank on board. Unfortunately, its president, Matyukhin, was not a convinced shock therapist, and rather proposed a more gradual approach to lower inflation, with a rhythm of 10% a month. With this goal in mind, he opposed to a drastic cut of State subsidized credits, hence creating a significant difficulty in managing budget deficit. (Åslund, 2007).

The real problem in carrying out monetary policy, though, also linked to the issue of credit, was the persistence of the so called 'Ruble zone'. The Ruble was the common currency of the Soviet Union and upon its breakup, it was retained by 15 of the ex-Soviet Republics. The control of the Ruble was still in the hands of Russia but each one of the mentioned Republics had its own central bank and its own monetary policy, with the subsequent power to decide on the issuing of credit. This possibility was of fundamental importance as it influenced both the interest rate and the decrease in GDP. The less credit was issued the more inflation declined, and vice versa, the less GDP decreased. (Goldberg, Ickes, and Ryterman, 1994) This mechanism significantly destabilized monetary policy in Russia, since the control of the currency was rendered practically impossible by the concomitant credit issuing strategies.

The only efficient solution for the problem would have been to exit the Ruble Zone and create a sovereign currency. Carrying out this process effectively was obviously complicated as it had to be sustained while the level of GDP was still at a satisfactory level, and inflation was not excessively high. In the case of Russia such reform, deemed necessary by Gaydar himself, was furtherly opposed by the fundamental will of retaining easy economic exchanges with the ex-Soviet republics and by the objective difficulties of undertaking the passage to a national currency. In the end currency independence was reached only in 1993, when the Russian Central Bank issued a decree stating that banknotes issued up to 1992 were to be taken out of circulation. This way, the States that wanted to remain in the Ruble area would have had to undertake a drastic change to comply with the Central Bank decree, prompting the majority of the ex-Republics to go off the Ruble and switch to national currencies. (Conway, 1995). This change, engineered on purpose to be abrupt and have the desired result of offloading States from the Ruble, had a drastic effect on the Russian population. The substantial change of currency, from the 'old Ruble' to the 'new Ruble', was not communicated to the population which found itself having exchange the currency about to be invalid within one day of the issuing of the Decree. This meant that the savings of Russians, already depleted by inflation, suffered an additional blow, as, predictably, it was almost impossible to exchange the totality of the old currency into the new one within a fortnight.

Despite the aforementioned measures, the experience of the 1998 crisis posthumously indicated that the rounds of reform of 1992 and 1993 did not have the stabilizing effect that was initially hoped for. One of the causes that could have negatively impacted the long-term performance of the monetary and fiscal reforms was probably the shortcomings that plagued the revenue side of the State balance of payments. The main problem in this regard was linked to the uncomplete reform of the tax system (Owen and Robinson, 2003) The latter had to be completely restructured after the fall of the Soviet Union, given that the extraction of taxes was to be based on an entirely new model of revenue and gainful activities. Due to the way in which the taxing mechanism was engineered, or rather not engineered, the government immediately encountered numerous difficulties in levying taxes. The main issue was not only taxing enterprises in their newly constructed private form, meaning taxing profits, but regulating the taxation system at the federal level. Territorially Russia is a very extended State which, until Putin's reforms, had a difficult experience in constructing the relationship between the various territorial entities and the center. This problem was specifically acute in the first years of Russia's history as the political aspect of federalism was still not settled, an issue that was compounded by a mixture of the necessity of retaining valuable resources locally and asset stripping from the center. This mechanism, which is compounded at the core by the difficulty in constructing a relationship between the State, Federal Entities, enterprises and individuals, was widespread not only in the phenomenon of taxpaying but also in the general reorganization of the country, from the privatization of state assets to the structure of key sectors such energy and military ones and the creation of the financial sector. This general confusion translated in an overlooking of the taxation system per se, which, despite the repeated efforts to boost enforcement through Commissions to tackle nonpayment and the deployment of police forces in the regions in 1995, did not achieve the desired result of a stable taxation system. The long-term persistence of the problem rendered stabilization much more complicated and with a lower prospect for long term success. (Boone and Fedorov, 1997).

The efforts to stabilize the economy were compounded by another pillar that was deemed fundamental to achieve the transition to a market economy, liberalization. The core targets of these reforms were mainly the liberalization of prices, which was implemented in the first months of reform, and the liberalization of foreign trade.

2.3.2 Liberalization

Price liberalization was the first reform enacted by the Russian leadership on January 2nd, 1992. The importance of this resolution was clearly linked to the necessity for macroeconomic stabilization, which implied getting rid of the distorted price system established during Soviet times. This reform, intended in its stabilizing function automatically translated into liberalization. Regardless of the effects that such measure had on the general public, it can be certainly said that the effort per se had borne the desired fruits, with the Price Liberalization Index ranging at 3.0, a satisfactory number (The European Bank for Reconstruction and Development (EBRD), 1995). The success of this arguably fairly easy effort was still met with increased difficulties in reforming and liberalizing the general workings of the market. Internally, this meant opening up the space to insert private individuals and enterprises into the mechanism of supply and demand, substantially achieving a complete turnaround of the mechanism of centrally planned production. This process was meant to be undertaken gradually, with the persistence of institutions such as state orders and a progressive opening in trading goods limited to some sectors, such as the manufacturing one. The liberalization of internal trade was also made increasingly complicated by the behavior of the federal entities within Russia. The main difficulty related mainly to the persistence of different price ranges for the same goods within different regions, deriving from the dependence on regional rather than state demand and influenced by the will of regional governments to cushion the impact of price reforms. (Gluschenko, 2002). This fragmented panorama persisted well until 1994 due to the substantial difficulties of carrying out inter regional trade, caused both by the collapse of the previous structure of distribution and by the lack of substantially spread market institutions, which resulted in the regional entities creating additional barriers to internal trade.

The most complicated trade reform, though, regarded the foreign rather than the domestic aspect of it. Liberalizing foreign trade was considered to have a significant number of benefits, first and foremost the arguable gains that could be achieved through trade by a national economy well integrated within the global one and, following the principles of global integration promoted by the IMF and WTO, also a significant advantage in terms of institutional harmonization of a variety of factors, such as legal codes and ownership patterns. (J.D. Sachs, A. Warner, A. Åslund and S. Fischer, 1995). The panorama for Russia's foreign trade was characterized by a double dimension that augmented the stress derived from the dissolution of the Soviet Union. All the Republics that were part of the previous system were intertwined in a system whereby intra state trade within the same industry was engineered in the way that sustained the production chain of a variety of goods. This meant that in some cases, to manufacture one single product, its elements would have come from a series of industries each specializing on a different component, and all located within the borders of the Soviet Union. When such framework disappeared it was certainly complicated for the majority of the new States to readjust, especially since most of the mechanism that regulated economic relationships between these countries were not sustainable in an environment marked by competitiveness. (Kierzkowski, 2000). Hence, a significant effort was made to conceive trade agreements that would somehow preserve the status quo. This effort of maintaining such commercial ties was constructed not on the acknowledgment that market dynamics should be the basis of the latter, but rather perpetuated through the instrument of State orders. Apart from being seldomly fulfilled due to the presence of better alternatives provided by the opening to the foreign market, they consisted in a missed opportunity to build a strong regional network of market relations between ex Republics of the USSR.

Foreign trade with other parts of the world was similarly difficult. The initial phase in liberalizing trade connections with countries outside the former Soviet Union's borders was primarily tied to attaining Ruble convertibility. During Soviet times the value of the Ruble was maintained at overvalued levels, so to render exports relatively expensive and imports cheaper. This situation of an artificial balance was coupled with a system of trade equalization measures and subsidies that effectively removed the difference between world market prices and domestically set prices. These measures effectively isolated the Soviet internal market from the global one, creating a lack of harmony between the two. The removal of these barriers and of the limitations on how much foreign currency could be detained by firms was then necessary to kickstart the process whereby integration within the global market could commence. The lift up of those effective restrictions to trade was initially carried out gradually, with different exchange rates remaining in place for exports, leaning towards an appreciated value of the Ruble, and on heavy subsidization of imports. These artificialities were ultimately removed by the second half of 1992, but wielded incomplete results due to factors deriving from concomitant decisions carried out in fiscal and monetary policy.

The main problem in this regard related mainly to incomplete price liberalization. Primary goods that were considered strategic, such as oil, gas, coal and metals such as aluminum, were subject to a pricing regime that was still controlled by the State. These prices were usually lower than their market correspondents, making it especially dangerous if they were to be exported without any control. During the first half of 1992 these goods were subject to a special set of regulations whereby the revenues of their sale, carried out in foreign currency, were to be surrendered to the State in returns for their correspondent in Rubles calculated at 50% of the market rate of currency convertibility. When such mechanism was eliminated in the second half of the year, creating a unified exchange rate set at market auction level, the exporters of raw materials benefitted immensely by the attractiveness lower, State set, prices had on foreign markets, and were able to achieve significant gains as a result. This phenomenon was compounded by the peculiar structure of such industries in Russia, one that was characterized by rapidly forming monopolies and a substantial level of asset stripping (Lipton et al., 1992). To try and curtail the problem the government engineered restrictions on who could carry out exports of energy and raw material, creating a list of "special exporters". Membership in this preapproved list though, could easily be achieved through the means of bribery, resulting eventually in all the major sector's industries being a part of it, allowing them to unduly benefit from the advantage of low domestic prices. (Mueller, 2007).

The second issue related to the difficulty in maintaining the exchange rate at a satisfactorily stable level. Unfortunately, the Ruble continued to depreciate through 1992 up to a rate of 400 Rubles for one US dollar. The main cause of such weakness derives primarily from the credit policy of the Central Bank which, as examined before, maintains the level of supply of Rubles at an unnecessary high level fueling both inflation and irresponsible use of capital. The uncertainty tied to the excessive and hardly regulated cover credit are furthermore compounded by the scarce availability of foreign currency resources, making it harder to fundamentally peg the currency (Lipton et al, 1992).

Both stabilization, and more importantly, liberalization were key pillars to ensure the long term functioning of the economy, and, crucially, necessary to implement the most important step towards the institution of the market economy, privatization. Despite being the core measure of transition, it was well recognized that without a sound ground base it would be impossible to implement it successfully, without a broader scenario characterized by general stability in the monetary and financial sectors. It was then hoped that the aforementioned measures would have created a background solid enough to offer newly privatized firms the chance to thrive in market dynamics, substantially 'flipping' the long-term effects of planning on the economy.
For its fundamental role in the process of transition, privatization was subject to its own reform process, with its own rhythm and strategy adopted. The specific provisions adopted in this regard will be analyzed below.

2.3.3 Privatization

Privatization was by far the most complicated aspect of the restructuring of the economy. The transition to private ownership of State Firms constituted a fundamental step in effectively sealing the fate of the command economy. Albeit being apparently the easiest of the implementable reforms, its implications would have had inherent effects that were fundamendamentally wider than any other macroeconomic reforms. The main practical aim of privatization was in theory a mere shift of ownership, but in practice it impacted a wide variety of variables that were fundamental for market existence. The emergence of long-term market competitiveness, and of a sound entrepreneurial spirit were in fact all to be derived from the success of privatization.

The options that were available varied both in terms of the content of the proposals themselves, namely how privatization was to be carried out, and in the speed with which they were to be implemented. Each of the numerous alternatives imagined that the various passages they entailed were the best feasible solution in terms of the aims to be reached and the constraints in place at the moment. In the case of all post-Soviet republics the main aim of the reform was to construct a system of enterprises that regulated their production on demand, so were demand sensitive, and that could successfully survive in a competitive environment. The first point specifically also related to the incentives that were to be behind the operation of enterprises, which had to be shifted from the possibility of securing state subsidies to the incentive of accruing gain. If such elements were to be instated with success it was then considered that issues such as technical innovation and firms' solvency would become independent form the necessity of intervention from above.

The constraints that operated in preventing the achievement of these objectives were dependent on nation specific conditions. In the case of Russia, the main problems related mainly to the firms that had to be privatized and to the political constraints inherent to to the process. The latter point was dependent mainly on the internal pressures and different ideologies that persisted in the sphere of government. The reforming faction, represented in primis by the figure of Yeltsin, had found substantial barriers in implementing privatization, objections sustained primarily by the ever-present reform averse representation in the Duma. This interest group, the effective residual of the old system, was especially rooted in the administration of a variety of key sectors, from the military to heavy industries, and was adamant that the scope of privatization, in the least, should be restricted. The representatives of the regions themselves were in collision with the central government, not only because the reforming enthusiasm had not effectively penetrated all the corners of the vast Russian Federation, but because taxation and the control of regional resources was considered a key issue for survival, especially of the local political elites. In light of these obstacles, a series of compromises were made, creating a specific configuration of the process of privatization in Russia.

The first issue in engineering privatization relates mainly to the speed with which it should be implemented. The Yeltsin administration, and the appointee in charge of privatization Chubais, had a strong interest in pursuing a swift change. The reasons behind this decision had mostly to do with the reception and the consequences of the restrictive policies of macroeconomic stabilization. It was in fact thought that privatizing would be one of the easiest reforms in terms of the toll it would have on the population, and that it would be met with a high degree of approval. This was fundamental as hyperinflation and other financial and monetary changes had the downside of drastically lowering the approval towards the government and its reforms, dynamic of which Gaydar himself had been a victim, having been fired in December of 1992 upon the wishes of the Duma. The factual strengthening of the communist type of political opposition could have possibly resulted in a drastic setback in the transition towards market economy and had to be somehow dampened. The second important argument in favor of fast privatization was mainly linked to the significant growth in unemployment that would have inevitably followed privatization. It was conceived that the fastest the process had proceeded the lesser the impact of unemployment would have been felt. A sweeping wave of bankruptcy and enterprise redesign should have been followed by the subsequent reemployment in the newly created private industrial sector, a mechanism that would have properly followed the laws of the labor market. Naturally, these considerations boded well with the ’shock therapist’ way of reform, and prominent advisors, such as Jeffrey Sachs, considered a pressing schedule necessary to protect a process that was “urgent and politically vulnerable” (Sachs, 1992).

The most basic engineering of the plan, in light of all the aforementioned elements, revolved mainly around two pivotal points, the differentiation between the privatization of small and big enterprises, and the transition from corporate to private form. The first point was somehow the easiest one as the privatization of small-scale enterprises was justly considered necessary to achieve the reemployment of shredded labor. They would have to follow a path that was outside the program of mass privatization. (Maksim Boycko et al, 1995) The method adopted in the case was the one of direct sale for cash, to be carried out by regional entities, which would have kept the revenue. The reason behind such decision was clearly politically motivated as the center was in no position to control the provincial federal entities, already upset by the effort of tax levying. This process, though, was riddled with high levels of corruption which resulted in only 75% of small enterprises being privatized by June 1994 (OECD, 1995). The privatization of such kind of enterprises was meant to compound the precedent wave of non-state enterprises created under the Law of Cooperatives of 1998, in an effort to boost the creation of a proper industrial sector that would finally respond to the demand of the public for commercial goods and possibly increase production, and GDP. This instance evidently failed, not only as a cause of the poor, and rather undeveloped entrepreneurially friendly environment but due to the regions’ disinterest in fostering this type of activities in their respective territories. This was mainly due to the structure of the tax system, which contemplated that most of the revenue from tax collection would go directly to the center and then redistributed to the provinces, constituting two third of their budget. There was no impelling need then for regions to ensure that firms accrued substantial revenues. The general situation resulted in lesser results that was expected, especially in the field of employment, as the growth of private small-scale firms after the first wave of privatization stalled at about 60%, a figure that was steady from 1995 onward, hence reducing the amount of workforce that could be employed in it. (Shleifer et al. 1991)

The second step towards privatization concerned larger firms, which were properly included in the privatization program. Amongst this category, there were to be further divisions. Firms of a significant size that were classified as light industries, such as textiles, food processing and furniture, were to be subject to mandatory privatization. Industries of a bigger importance were to be privatized in accordance with the permission of the specific ministry, while those that were considered to be ‘strategic assets’ could only be privatized with the authorization of the government. These enterprises, mostly related to the energy and military field, were hence in the hands of a government that was mostly contrary to reform efforts, primarily due to the fact that the interest groups connected to those industries were pushing against any effort of privatizing highly profitable firms. The only effort that was permitted in this sense was a partial ownership by privates of part of the equity.

The path to be followed by those enterprises that were indeed to be subject by privatization was to be undertaken in two steps, the first one being corporatization, as per the decree signed in June 1992 by President Yeltsin. This tool was designed to somehow soften the impact that fast and total privatization would have had on enterprises and ultimately production. The idea behind the need for such intermediate step derived mainly from the objectives that were ultimately hoped to be attained through the latter. Fundamentally, it was considered, even by the likes of Sachs, that leaving enterprises without any access to State subsidies would have been detrimental for the entrepreneurial class to gradually develop the abilities to successfully manage firms in a competitive environment. Under the guise of corporativism firms were to be registered as joint stock companies, with all equities to remain in the possession of the State, but the effective control of the enterprise in the hands of a board that included management, workers, suppliers and customers. It was conceived that this compromise would gradually introduce incentives to maximize profits, mainly deriving from a competitive environment and the introduction of hard budget constraints, without the bunt impact of proper privatization.

The procedure to be followed next, that would ultimately finalize privatization, could take a double form. Each corporatized firm could ultimately make a choice between two paths. The first one entailed that workers would get 25% of the shares of the company they were employed in for free but would lose the power of vote in the board. Managers, on the other side would have been able to purchase 5% of the shares of the company at their nominal place, the one decided when the firm was valued. After privatization itself both workers and managers would have been entitled to an additional 10% of the shares but this time with a discount of 30% on the nominal price of shares. The second option available entailed those managers and workers would be jointly in possession of 51% of the equity of the firm, to which voting power was attached, which could be bought at nominal price of 1.7 of its value, a substantially depreciated one. A further 5% could be obtained after privatization with the same criteria applied to the first option.

The means through which shares could be bought were various. Workers already part of the enterprise could also purchase shares in cash or using the retained profit of the firm. The most common method to acquire shares, though, was through the use of vouchers. This strategy, characteristic of Russia’s privatisation, entailed that every citizen was offered a voucher, valued at 10000 Rubles, approximately 40 US$, with which they could participate in the auction of public firms. Each enterprise would hold a local auction upon the proposal for its privatization being submitted, where the aforementioned vouchers could be used to purchase stock of the company. This method was conceived to hopefully involve the population in the effort to reappropriate for themselves of what once was State property. Most Russians did indeed embark on the process, with the majority of them buying the vouchers for the moderate price at which they were sold.

The main issue with such plan, both from the point of view of the population and that of the workers, was the general confusion with which the introduction of such instrument was carried out. Most ordinary Russians did not have the sufficient tools to correctly grasp the way vouchers could be fruitfully used despite the wide, mainly Treasury sponsored, publicity the plan enjoyed before its implementation. The inclusion of the wider population in the program, and the great involvement of workers, resulted mainly from an attentive political calculation which saw both the need for increased support for the leadership and for the resistance to inter-governmental pressures that would have wished for most of the firms to be relinquished directly to workers, making privatization obsolete. What happened in reality was that the majority of the population did not possess the necessary ‘speculative’ intuition to use the tool of vouchers correctly and, most importantly, was under heavy stress form high inflation rates and the subsequent loss of real values of salaries. This resulted in most workers selling the shares to managers of their own firms, and in general, in the majority of the population offloading their vouchers in exchange for much needed cash money.

The usefulness of the voucher system, however, did not pass unnoticed by most firm managers and speculators. Both figures are peculiar to the Russian panorama and a by-product of the economic history of the country. The role of the firm manager was already prominent during Soviet times, as it was tasked with maintaining the delicate balance between obtaining state subsidies and producing the necessary quantity of output. As analysed before achieving targets was rewarded with benefits, a system that coupled with the existence of soft budget constraints created a peculiar attitude towards the logic with which firms were run. The system functioned, albeit inefficiently, as long as the command structure withheld, but came crashing down with the reforms of Perestroika that targeted State enterprises.

The issues with the latter, and arguably with the privatisation method adopted in Russia, is that they both failed to instate sufficient controls to avoid asset stripping, or, depending on the point of view which is adopted, to create the right incentives and constraints to ingrain the necessity to make enterprises effectively profitable. Neither of the two were obviously came to reality in Russia. The possibilities of institutions to actively oversee key changes such as privatisation were highly compromised by the internal conflicts in the higher spheres of power, between regions and amongst different interest group, a scenario that was compounded by the general lack of enforceability that followed the disruption of the administrative system of the Soviet Union. On the other hand, the strategy with which reforms were structured did never inevitably result in a substantial affirmation of hard budget constraints. Both monetary policy, with the largeness of the issuing of credits, and privatisation contributed to the problem. The main issue with the latter lied primarily in the way with which it was structured. The government found itself in a position in which it was not possible to force the enterprises to privatise, as their interest group was heavily represented in the Duma. In exchange for eliminating the gridlock that was blocking privatisation, officials agreed to avoid the imposition of major external shareholders on companies, hence allowing the managers to retain power over their enterprises. Despite being assigned rather limited shares in the two plans envisioned to carry out privatization, their power to access large funds and exploit the voucher scheme, which made this instrument tradeable, by buying up large stacks from workers and citizens resulted in substantive gains without any necessity to fundamentally restructuring enterprises. The rush to privatization also opened the road for speculators to gain unduly advantages from the process. Such figures emerged mainly with the Perestroika reforms and the creation of Cooperatives, enterprises that were born in a setting that implicitly encouraged a behaviour that was based on the exploitation of gaps left uncovered by the new policies. This could consist in taking liberties with pricing, exporting goods at rather convenient rates, engaging in commercial activities based in the black market, participate in dealings of foreign currency and in corruption of institutions and police. The capital accumulated through these dubious means was well put into use during the privatisation process, resulting in significant asset stripping and wild speculation over the value and property of enterprises.

The principal failure of the privatization reform, though, was mainly linked to the fate of the companies that were kept out from the first privatizing wave of 1992 and 1993. These enterprises were considered too strategic to be auctioned though the means of shares, hence their transformation into private companies was delayed until the government approved it and devised a specific route to be pursued. First of all, it was deemed necessary that firms that were operating in key sectors had to be reshaped in a way that could allow for an easier privatization. The government achieved this by aggregating the controlling stakes of more industries operating in the same sector into few holdings. When they were to be privatised the government would in turn sell controlling shares of the holdings to buyers. The most important companies that emerged as a result of this process included the likes of LUKOiI, Sidanko, Sibneft, Rosneft, Tyumen Oil, Yukos, and VNK in the energy sector and United Energy Systems and Svyazinvest in the energy and telecom sectors.

How the privatization of these corporations unfolded is a phenomenon that is strictly intertwined with the political circumstances of 1993. During the year, the clash between Yeltsin and the Russian Parliament had reached a boiling point over the outcome of reforms. The growing opposition effectively created a gridlock that rendered the path towards transition almost impossible. The President, availing himself of powers that were not clearly assigned to his role, decided to dissolve the parliament, a move that was instantly deemed unconstitutional by the latter and lead to his deposition. The response of Yeltsin was to mobilize the army into repressing the 'parliamentary rebellion' and reinstating him into power. The move succeeded and Yeltsin was able to modify the Constitution by giving it a stronger presidential imprinting. The problem of the legitimacy and approval of his time in power though, persisted, as the 1993 elections of the State Duma saw a growth in the seats awarded to the opposition. To compound this situation there was a pressing need to increase the drastically low entries of the State, which was struggling to maintain a positive balance of payments and provide the population with the salaries and pensions it owed them.

Privatising companies as big and valuable as those examined before could have served both scopes. It is at this point that the process of privatization moves in the territory of active mismanagement and corruption, rather than of mere shortcomings in the control of the process. The core of what came to be known as the 'loans for shares' system constituted mainly in the State relinquishing some of the quotas of these companies to private citizens and banks, also controlled by powerful private individuals, in exchange for loans to the state budget. The entire process was constituted in a way that allowed buyers to get hold of shares of majorly profitable companies for a relatively depreciated value, and then never have to return their ownership to the State. The auction process itself was structured to precisely allocate to each of the bidders the shares they desired most for the prices they requested, formally eliminating competition. (Treisman, 2010). Furthermore, if the loans granted to the State by the auctioneers could not be repaid by 1996, the new owners were allowed to auction off their shares and keep 30% of the revenue of the sale. What happened in reality was that loans for 800 million dollars were purposefully not repaid, leaving the businessmen that came to be known as oligarchs with basic ownership over the most profitable of Russian firms. (Treisman, 2010). This transaction, carried out on blatantly unfavourable terms for the Russian State, had its returns in that oligarchs pledged to support Yeltsin's re-election campaign in 1996. Due mainly to the intensive effort of publicity and other means employed, the President ultimately managed to gain another term in power.

In hindsight, the effects of this historic compromise between the two parties were disastrous. Not only did the public recognise immediately the fraudulent nature of the privatisation of large national assets, the political sphere too became hostage of the pressures of oligarchs. For what pertains to the public perception of the late effort to privatise, the episode served to seal the impression that the transition to market did nothing more than benefit a restricted group of highly corrupt people. (Black, Kraakman, Tarassova, 2000). Yeltsin's administration, recognising the rampant discontent, quickly disposed of Chubais, the men in charge of the privatization efforts, in a hope to reconstruct his base of consent. In the long run Yeltsin political demise appeared inevitable but, more worryingly, the Russian people seemed to have adopted rather negative associations to the concept of private ownership. In the delicate situation in which most of the population was already in distress from contractive monetary and fiscal policies, it would have been important to carry out the awaited privatization in a way that could justify the loss of the benefits enjoyed in the Soviet Union. Due to the corrupt, or in the best cases extremely confused, transition to private ownership the wider perception was that the possibility to do business freely and own enterprises was not a fair bargain in respect to what the old system offered. In time this attitude evolved not only in the fact that the Communist party never effectively disappeared from the political scene, but that the general perception associated with entrepreneurs was one of diffidence, sentiment usefully shared by the Putin administration. This reality is to this day reflected in the rather peculiar makeup of Russia's commercial law, which, to cite only an example, is still subject to the penal rather than the civil regime.

The other problem that emerged with the birth of the class of oligarchs was also related to the sheer power they gained in the economic sphere, coupled with the subsequent ability to influence politics. The economic component to their influence increased over time, creating a situation whereby certain sectors were dominated by the presence of corporations with such extensive market power that the vast majority of the sales in it were dependent on them. One such blatant case of is the market for aluminium, where 80% of the sales were dependent on Rusal alone (Guriev and Rachinsky, 2005). Regardless of whether the management of enterprises was being well conducted or not, it is undoubted that such a heavy presence in a variety of sectors in the economy exacerbated the already high barriers of entry. Furthermore, despite possessing a significant influence over government it has not been common practice for oligarchs to lobby for the interest of other businessmen operating in the same sector. The other setback deriving from the presence of a strong oligarchy has to do with the impact they had on the newly formed Russian democracy. It is a widely shared opinion that the presence of such an effective lobbying mechanism, coupled with the high levels of corruption both at the regional and central level at least slowed down the democratic benefit that a wider class of entrepreneurs could have achieved. (Stiglitz, 2002; Goldman, 2004; Hoff and Stiglitz, 2004).

Overall, the complicated legacy of privatization, of financial and monetary policy and of the efforts to liberalise effectively set the tone for future developments in Russia. Such influence will be analysed in the last chapter of this work. Before moving to this argument, though, it would be apt to summarise the underlying characteristics of the reform plan and possibly analyse whether an alternative path of transition could have wielded different outcomes.

2.4.1 Concluding remarks on Russia's transition

From what can be understood from the analysis above, it seems that all the steps that were theoretically necessary to undertake a sound transition to market were implemented, yet, during the decade ranging from 1989 to 1998 GDP declined roughly by 50%. This affirmation, in fact, does not aim to overlook the errors that are apparent when the reforms are considered in their content and consequences, but rather at trying to understand what were the elements that might have been crucial to determining the evolution of the market in Russia. The key consideration in this analysis must depend on a basic starting point. The main difficulty in assessing the reform plan is the inevitable intricacy with which each one of the reforms was tied to a series of other variables, societal, political and historical, other than the economic one. That said, it is necessarily hard to determine with complete accuracy which were the factors that caused the single reform to not wield the desired results in the specific field it was meant to address, but it could be possible to highlight what were the main shortcomings of the transition plan as a system. If similarities between the outcomes of the reforms had to be compared, it would probably appear that they all seemed to have partially missed the mark.

In fact, it is not that the reforms had been completely inefficient, as they did target the scope they were designed for and fundamentally change the core structures of the command economy. It is without a doubt that, on paper, most of the fundamentals of a market economy were established. Competition, free prices, private enterprises, the external trade regime were all introduced thanks to the reform plan and were indeed much a reality by the end of the 1990s. Still, it is evident that the Russian market economy is a very peculiar type of such. The core reason for this rarity may lie in the interaction between the reforms and the specificity of the country.

First of all, the primary design of the transition plan was based on fundamental beliefs that had to be *applied* to Russia. The propositions of the Washington consensus and the approach that derives from them are a set of rules, almost a medicine, that has to be imparted to the country which may need it. This meant in substance that rather than organically link the reforms to the economic tradition of the country, the whole past structure was dismissed and replaced. One may argue, not incorrectly, that by 1992 the state of the economy was so dire that such resolution was needed, and that there was little to be saved from the ruins of the command economy. Still, it is to be asked whether it is possible to achieve a successful transition without a solid starting base, meaning taking well into account the mechanisms and behaviours that contributed to the workings of the previous system. How this can be achieved is another question, gradualists such as Stiglitz thought that a slower reform rollout might have helped in softening the blow of a drastic change, and shock therapists too were aware of the basis from which they were operating, and they did indeed try to incorporate such awareness into the structure of the reforms.

The issue though has another layer of complexity, as the inefficiencies of the command structure were not only economic in nature. Arguably, as it would become evident during the first years of reform, such distortions heavily impacted not only the workings of the economy, but the attitudes of most of the actors that were tasked with translating the transition into reality. This observation is not limited only to the political class and the administration but also pertains to the 'recipients' of the reforms, citizens and entrepreneurs alike. From the analysis conducted in the first paragraphs of the chapter, the trend that seems to be shared between the wide array of reforms implemented is one of unexpected reaction to the measures put in place. Well-constructed plans aimed at tackling key structures of the old system, such as the configuration of external trade or the system of property ownership, somehow did not achieve the transformative impact they were meant to have, but rather combined with 'the old ways' to create a new hybrid result. The final outcome might have been heavily impacted by corruption and kleptocracy, but it is evident that none of the reforms managed to achieve their intended potential after they came in contact with the distortions that characterised the old system. The World Development Report titled 'From Plan to Market' (1996) argued that the shortcomings of Russia's transition were the result of the very real existence of 'good' and 'bad' policies. It is still worth contemplating, though, whether the heritage from the past economic tradition can be eliminated through active and coordinated reform plans, whether they are gradual or immediate, or if such outlook is just a theoretical one.

In the case of Russia, the first years of active and intense reform activity, which protracted until the middle of the 1990s, were then followed by a period that appeared of acceptable stability. Despite the setbacks the reforms encountered it was considered that if the pillars of market economy were in place the situation would improve with time, with growth in productivity and GDP. What happened instead was a decisive crisis in 1998. The causes of this late failure of the economy are various and well rooted into the first years of reform. It appears in fact that the stabilization that was sought after did not materialise. The causes for this outcome lie primarily in the fact that many of the reforms, with some particular highlights, were not tailored to the real possibilities of the Russian recovering economy.

2.4.2 The crisis of 1998

Among the key catalyst for crisis were the issue State debt and the system of foreign exchange. Albeit both being of radical importance to causing the crisis, the majority of commentators prefer to highlight the role of the foreign exchange issue as the most important structural cause (Popov, 1999).

The exchange rate policy has its roots in the necessity to stabilize the economy. In Russia as in many transitional economies the exchange rate assumes the role of being an *anchor value.* An anchor is a nominal value fixed within a range that would essentially tie economic actors to a well-defined monetary value. This device helps controlling a variety of factors, primarily inflation, through the development of constraints to high levels of interest rates and the higher cost enterprises would sustain in case they raised prices. Problems arise when the anchor value, which is nominal, is not well adjusted to the real value. In the case of the exchange rate, committing to keeping it fixed between a maximum and minimum range is detrimental when the real exchange rates rise. First of all, the impact on the balance of payment is negative as imports are made more attractive and exports costly, which leads in turn to a devaluation of the currency as a result of the outward flows of foreign currency from Central Bank reserves. Secondly, as the nominal anchor drives inflation down, the State might be tempted to increase government spending as its impact on inflation is significantly lower, creating a strained situation on the state budget.

In Russia the nominal anchor, based on the exchange rate between Rubles and US Dollars, was not updated to real exchange rates, remaining the same from 1995 up to 1998, despite the struggle of the Central Bank to commit to this policy. To maintain the value of the Ruble to US$ within a value of 5.3 to 7.1 the Central Bank bought Rubles if the exchange rate tended to exceed the value and vice versa, creating a substantial strain on monetary policy. Most importantly though, the result of this resolution was that the real exchange rate grew rapidly and was driven up to peaks of 200% in the last years before the crisis. The consequences were dire both on the structure of the internal economy and on the balance of payments of the State. For enterprises in need of a pervasive restructuration, case widespread in Russia, the competition with imported goods was simply unbearable, and resulted in the abandonment of efforts aimed a constructing an internal net of commercial ties that would have resulted in domestic industries able to produce complex products (Sapir, 1999). This consequence was almost inevitable for Russian industries as they were only just privatized and would have had to quickly adapt to a very stringent credit policy that essentially deprived them from any form of investment, a situation diametrically opposite to the one that had subsisted in the command economy. As a response to the rapidly increasing difficulty of making industries profitable and maintaining them afloat, most of the efforts were concentrated on sectors that had a greater chance for survival. A good that was largely available in Russia and that never ceased to be in demand was natural resources. It seemed then only logical that most of the investments were diverted from other industries to the energy sector, creating a handbook case of what is known as *Dutch disease*. This was signalled by the composition of exports, composed by 1996 of 38% by natural resources. (Chapman and Mulino, 2001). The essential deindustrialisation (Sapir, 1999) of the internal market created the basis for Russia's dependence on exports of natural resources, instance that is very much the case in these days as well.

The high levels of the real exchange rate also had a detrimental effect on the balance of payment. Normally, in developing or growing economies, the exchange rates are kept low so to incentivise exports, that would generate the necessary affluence of foreign currency to sustain the debt. The policy adopted by Russia, on the other hand, resulted in the opposite effect and exports' growth decreased by 8% to stall completely in 1997 (Popov, 2000). Imports, on the other side registered a steep increase, reaching a total of almost 7,34 billion US$ in 1997, progressively reducing the share of the internal market supplied by Russian goods. The trade balance of the Russian federation then turned into negative values, with a deficit of -3,5 billion US$ reached by the beginning of 1998. The increased number of imports resulted in a fatal blow on the Central Bank's reserve of foreign currency, with the consequent decrease in the trust vested in it.

The problems caused on by the now unbearable policy of the nominal exchange rate were compounded by the impossibility of maintaining the State budget positive. As examined before in this discussion, the entry side of the budget was heavily plagued by the impossibility of extracting revenues from taxation, due to the incomplete reform, the interference of regions and the shrinking taxation base. The expenses of the State, on the other hand, did not decrease, reaching peaks of 20% of GDP in 1997. The financing of the expenses of the state increasingly relied, due to the stringent monetary policy, on the issuing of State bonds (GKOs), to be sold internally and then on foreign markets. The State debt continued to grow as a result of this policy, causing increasing worries on the state of the national economy.

Despite the debt issue, the main preoccupation of investors was mainly related to the issue of the nominal exchange rate, creating worries on the actual value of the Ruble, rather than on the possibility of a default on foreign debt. The cost of maintaining the nominal exchange rate had by the end of 1998 an extensive toll on the Central Bank, which had at this point turned to foreign reserves to finance it. The breaking point occurred on the 17^{th} of August 1998, with the Russian government posing a moratorium on the payment of internal debt so to allow for its restructuring and avoid the default of the Central Bank, and announcing a revision of the nominal exchange rate, which was ultimately abandoned in September of the same year. The depreciation of the Ruble that followed immediately resulted in inflation. Prices increased by 38%, causing shortages and kickstarting panic in the population which responded by withdrawing substantial amounts of cash, endangering the existence of a number of banks which could count on little amounts of deposits to begin with.

The crisis of 1998 fundamentally sealed the economic fate of post reform Russia, unveiling the major shortcomings of a transition that was not well suited to match the real ability of the economy, and that introduced reforms which were guaranteed to ensure stability and growth but rather created only a façade of such. The issue of 'stability' intended both as political and economic became the starting base for the creation of the modern form of Russia, its two decades under the Presidency of Vladimir Putin.

Chapter three

3.1 The demise of the Washington consensus and the myth of stability

The 1998 crisis had far-reaching consequences for the evolution of Russia's economic history. The events of May of that year demonstrated unequivocally that misapplication of the principles of the Washington consensus may have disastrous consequences for a country's economy. The recovery from the failure of what was supposed to be the ultimate cure for the post-Soviet Russian economy had significant ramifications, not only in terms of the path of subsequent reforms, but also on broad opinions towards what was needed and expected from the economic management of the State.

In Russia, the reforms of the post crisis period, orchestrated by the Primakov government, strongly focused on re-establishing a degree of control over the workings of the market economy. Amongst the most prominent reforms implemented in the last reforms before the end of the 1990s, the control over foreign trade and the re-emergence of subsidies and general softening of the management of the budget. Reforms in the banking sector were also central in the reorientation of the economic policy of the country. First of all, in terms of trade, a protectionist policy was adopted, imports were heavily reduced in some sectors, to shield the internal industry on the country from unsustainable competition. On the export side too, more stringent control was introduced to prevent capital flight and exploitation of the trading regime, firms were now compelled to sell 75% of the foreign currency they gained to the state to the Central Bank. The State also stepped up in assisting both industry and consumers introducing subsidies that could help increase production and maintain demand stable, as well as increasing the State expenditures to cover for the salaries and pensions that were still owed. To reduce the confusion and instability in the banking system the State incorporated many banks and created new limits on the necessary level of reserves, extending the banks that could count on deposits backed by the Central Bank. These reforms, amongst others, aided Russia in the unexpected economic rebound of the economy. A lot of factors contributed to the GDP growth of 1999, which amounted at roughly 5,4%, amongst which the surprisingly high savings in dollars that Russians had managed to retain and the rise in the price of energy exports, but certainly the more prominent role of the State had a key role in sustaining the post crisis economic rebound.

The necessity to reinsert the latter as an important player in the economic panorama derived mainly from the impression that the scaled back role it had enjoyed up to that point was detrimental to the wellbeing of the economy. The reasons behind the little role the State had in regulating the latter were various and derived from both theoretical arguments and legitimate concerns. Evidently, if the reforms carried out in Russia were based on the Washington Consensus, a neoliberal set of precepts, the State was to cover a limited role. The added element in the case of Russia was mainly based on the starting conditions from which transition had to be implemented. Since the role of the State was so pervasive in the institution of the command economy it was considered impossible to eliminate the distortions of the latter if it was allowed to retain its position as a regulating agent. This point of view was also corroborated by the political conditions that were present in the country after the fall of the Soviet Union. The permanence of a variety of powerful interest groups, such as the military and the nostalgic communist one, were an evident threat to the possibility of achieving an impartial regulator. This was a serious concern when, after the crisis in 1998, the State changed its economic policy towards having a more prominent role within the market.

It is certainly interesting to analyse whether these concerns actually translated into reality during the twenty yearlong Putin era. Certainly, the changes introduced in 1998 and 1999 were not meant to be the first steps in the ever-growing centrality of the State that came to be during the last decades. The causes of such scenario, that has come to impact both the political and the economic life of the country, certainly have their roots in the complicated transition that occurred in Russia during the 1990s. The main theme that emerged from the latter was a cry for 'stability'. The meaning of the term is difficult to pinpoint in the case of Russia, primarily since the benchmark of what can be considered stable or not has its roots in Soviet history and in the comparison with the subsequent decades. The stark contrast between the cocooned reality of the Brezhnev era and the turmoil of the Yeltsin years was all too clear in the mind of most Russians and had a central role in shaping the attitudes and expectations of the population for the years to come. The issue with such expectations was primarily due to the fact that the old system had disappeared. Under the new market institutions, the communist model of economic and societal organisation could not be replicated in any way unless there was to be a return to the old ways, scenario that by the end of the 1990s was impossible to materialise. The grievances of the population that originated from the rather traumatic years of transition, though, were still very much present and would eventually come to have an impact on the subsequent evolution of the country, albeit in concomitance with the new system that emerged after the transition to market economy.

What added another layer of complexity to this comparison between the old and the new system, though, is the double dimension the desire for stability entailed. In post crisis Russia, both economic and political stability were two aims that were sought after, as the dire economic conditions of the country were coupled with high levels of dissatisfaction towards the Yeltsin leadership. The peculiarity of Russia's case lies mainly in how these aims were supposed to be achieved. The experience of the country under Soviet rule saw the State embodying both the political dimension, through the party structure, and covering the role of provider of economic policy, as the command system presupposed a centralised entity that was in charge of the working of the market. The alternative to this method was the one that emerged in 1991 after the fall of the Soviet Union. The economic dimension should be regulated by the principles of the market, with minimal State intervention, and the political one should pertain to the institution of democracy. The issue with this alternative is that it fundamentally failed, not only in the practical dimension, but also in terms of the hopes of the population, which expected greater equality and improved conditions from the reforms of the early nineties.

The failure was most visible in the economic dimension, as the 1998 crisis demonstrated, leaving a lasting negative impression of the soundness of market economy ideals. By 2006 only 32% of Russia's citizens believed that the institution of a market economy, with little involvement from the State, was the right way to go to for the future of the country (Gallup poll, 2008). The institution of democracy was also left in a crisis from the experience of the 1990s, as Yeltsin's presidency was rocked by at least one significant constitutional crisis, in 1993, and by the blatantly rigged elections of 1996. Within the parliament itself dissent was continuous and corruption rampant. These events served to corroborate the doubts that had emerged right after the fall of the Soviet Union, on whether the newly democratic order was a result of modernizing pressures that were effectively present in the country or just a fortuitous by-product of the disintegration of the old system (McFaul, 2021).

The admixture of the need of political and economic stability, the failed result of the reorganisation of Russia after 1990, and the Soviet past of the country, was probably what set the country on the course of the style of leadership Putin ultimately adopted. The fact that he was a member of the old Soviet elite, and in particular of the KGB, was also an indicator of the direction in which Russia would evolve in the future years. The resurgence of the 'old guard' naturally came with the change in leadership that occurred after the crisis of 1998, when the governments started to include figures such as Primakov or Gerashchenko that were exponents of the old Soviet system. With the Putin leadership the communist elite was fundamentally excluded from active government and was instead replaced by a complex system composed by the so called *siloviki*, a class of bureaucrats composed by ex-members of the security agency of the KGB, which Yeltsin had left intact, and military police. This instance was the effective signal that in times where the situation in the country tended to be unstable, the best possible option was not to turn to the institution of democracy to channel the grievances of the population, but resort to the impression of stability embodied by the Soviet style of leadership, centralised and controlled by an ad hoc class of rulers.

Albeit Putin himself being an outsider form the proper communist faction, as he had been chosen carefully by Yeltsin from outside its ranks to avoid the return of the latter in a position of power, in its style of government he was still able to exploit the feeling of nostalgia towards the stability of Soviet power. The undemocratic turn its presidency undertook was certainly facilitated, if not dependent, on this feeling. The result was the current make out of the Russian institutional panorama, one that is marked by stark anti-democratic tendencies. The creation of what has been defined as the current 'managed democracy' (McFaul, 2021) has been structured on a variety of pillars. First of all, the main trend has revolved around the gradual undoing of democratic institutions, a blatant example of which is the extension of the length of presidential terms and the possibility to be re-elected more than the number of terms initially allowed by the Constitution. The Duma, the organ that was meant to check presidential power was also reduced to the mere function of rubber stamping the decisions of the President, as the party that has consistently won most seats in the elections was the Putin endorsed United Russia. The opposition was also reduced to a merely nominal role, as a complex set of electoral barriers and covert rewards for collaboration were introduced to render its role essentially obsolete. The second pillar in discrediting the institution of democracy was mainly linked to the restructuring of the identity of the Russian nation. The heritage of the status of superpower and the consequent belief of the special nature that was to be accorded to the heir of the USSR was structured in a way that put the West and Russia in stark opposition. One of the pillars of this discourse was the instability of democracy, compared to the order that was present in Russia. The result of this campaign has translated in 47% of Russians stating that they don't hold so called 'democratic values' (Levada poll, 2021).

Still, despite the drastic back turn towards the road of democracy, during the initial terms of its presidency Vladimir Putin himself supported a series of reforms that went strongly in the direction of further liberalisation and support for private enterprise. The reasons why this support has consequentially died down will be analysed in the paragraph below, hopefully highlighting how the structure of the economy and the evolution of the political panorama has allowed for such instance to take place.

3.2 The economics of stability

3.2.1 Putin's first presidential term: from 2000 to 2004

The first years of the Putin presidency, from 2000 to 2004 were marked by a high level of growth, averaging an annual 7%. The reasons behind this increase were tied to numerous factors, some independent from the action of the Putin administration, and some indeed resulting from the reforms put in place during his first term. The abandonment of the demanding nominal exchange rate immediately resulted in benefits for the economy, as did the curtailment of imports. These factors directly resulted from the aftermath of the crisis of 1998 and were not dependent on any particular institutional input. What they created instead was a window of opportunity for reforms that could have a longer stabilising effect. The Putin leadership was aware of this circumstance and indeed tried to exploit it through the design of a set of reforms that were meant to finally correct the workings of the Russian market economy. This would have then hopefully resulted in an annual growth of about 8% and in the admission in the WTO, pursuit that was later abandoned.

The so called Gref plan, named after the Minister of economic development, essentially had this aim. Its core propositions revolved around fiscal reforms, the overhaul of the banking system, a series of additional supports to liberalization, and privatization. (Åslund, 2007). All these reforms had a strong liberal tone and aimed at removing the barriers that were detrimental to the growth of the entrepreneurial environment in Russia. The first and more pressing issue that was to be addressed related mainly to the necessity to review fiscal policy. Taxation had always been an issue in the country especially since the center and the regions competed in extracting revenue from private citizens and enterprises. This resulted in widespread overlapping of taxes at the regional and at the national level, which in turn implied a high level of tax evasion and a discouragement for foreign investors to do business in Russia. To resolve this issue the government drastically reduced the number of taxes to just 16 by 2004 (Åslund, 2007). The proportion within the latter was ten federal taxes to six regional ones, a balance inverted from the original distribution. This disposition was made possible by the strong push to centralize power at the central rather than at the regional level, essentially reducing the capabilities of the Federal Entities to have any real autonomy, economic and, primarily, political. Importantly, amongst the federal taxes, the income tax was designed as a flat tax set at 13%, effectively relieving a burden on private citizens and encouraging them to participate in the economy. This measure had the desired results as the entries from this specific type of taxation increased from 2,4% of GDP in 1999 to 3.3% pf GDP in 2002 (Åslund, 2007).

The second principal target of the reform impulse designed by Gref was the effort to reduce the bureaucratic burden on enterprises. The number of licensing requirements and the ever-changing regulations on the matter significantly impacted the business environment in the country and created a hotbed for corruption. The number of requirements to start business activities has subsequentially been cut, improving the situation and allowing for smaller and medium enterprises to develop without the burden of unnecessary regulation. The banking system was also reformed by guaranteeing smaller banks with a government deposit insurance so to render them more competitive against banks that had state backed funds. This measure would have hopefully helped differentiating the credit panorama and avoid the insurgence of banking institutions that primarily had a speculating function, which had previously endangered the market during the crisis of 1998.

The slew of reforms aimed at improving the business environment were also corroborated by a reform of the Judiciary. Such effort was deemed necessary since most of the courts were financed at the regional level, which rendered them vulnerable to micro dynamics of corruption and overall, a rather weak institution. The reform did indeed succeed in establishing a strong judiciary but as a result shifted its financial dependence on the center rather than on the regional level, substantially depriving it from the necessary level of impartiality that was required form it. This fundamental change in allegiance was confirmed when the courts overlooked and endorsed a series of accusations against powerful oligarchs, such as the head of the Yukos oil group, Khodororkovsky, to accommodate the political interest of the central administration in eliminating opposition (Goldman, 2004).

Alongside structural reforms social reforms were also implemented to target the most pressing issues that had been plaguing the Russians population since the fall of the Soviet Union. Targeted reforms were introduced to reduce poverty amongst the population and pensioners driving the rate of people behind the poverty line back from 29% in 2000 to 13% in 2007 (World Bank Report, 2007). In general, during the first term of Putin's presidency the living conditions, and lifespan, of Russians greatly improved: private consumption increased to 49.0% of the country's GDP, real disposable income registered an increase of 7.9% until 2008 and the unemployment declined to 6.3% until the same year (Cooper, 2009).

These positive changes strongly contributed to the popularity of Vladimir Putin and somehow aided the transition to 'managed democracy' as the population, seeing their conditions improve after more than a decade of turmoil, happily embraced the new order. Under the economic point of view the situation appeared more complicated. Despite the impression these round of reforms had given, apparently reestablishing a solid ground base for enterprises to follow on the path of growth, these hopes seemed to be somehow unfounded. It can be argued that the resurgence of the economy during the early 2000s was primarily a result of the effective employment of the significant Soviet industrial power that had remained unutilized during the Yeltsin years because of the chaotic situation of the economy and of the unfavorable conditions to carry out business successfully.

As it proved in the following years of Putin's long presidential stint, the incentive to improve the conditions of the economy in a direction that fostered entrepreneurs came second to a series of other factors, especially political interests.

3.2.2 Putin's second presidential term: from 2004 to 2008

After the hopes the first term of his presidency had brought, the second term of Vladimir Putin's rule of Russia assumed a drastically different tone. The four years that would follow would mark the return of the State in its prominent position, this time flanked by a restricted group of powerful economic actors. This new structure of the economy can be de defined, to better clarify, as 'oligarchic capitalism' (Hoffman, 2002). The main core of this new system lies mainly in the fact that the general organization of the economy remains one with the characteristic of the market economy, but the control of key assets is in the hands of a few selected companies and of the State.

In Russia this particular conformation was allowed to take shape for a variety of reasons. First, the presence of extremely profitable companies, created as a result of the stripping of the most valuable assets of the defunct Soviet Union. Secondly, the most profitable assets in the country were those tied to the distribution and production of oil, gas and rare metals, all goods in high demand in the international market.

Aware of the powerful impact large private corporations could have on the stability of the country, especially in political terms, the Putin administration quickly moved to take the situation under control. This action was undertaken through a double channel. First of all, a deal was struck with the most powerful oligarchs in the country. These individuals, by the time of Putin’s ascension to power, had already been in a significant position of advantage, both economically and politically. Their wealth had profited greatly from the confusion of the 1990s and had managed to get them closer to the leadership and further their interests. Following the 1996 election tradeoff, their political presence was solidified as well, as they became part of what became known as Yeltsin's "*semya*" (family). Putin, though, was no Yeltsin and as soon as he came into power, he clarified the relationship with the oligarchs (Marshall, 2004). They were to keep their power as long as they did not interfere in the political dimension. This tradeoff was convenient for both parties as the new administration could benefit from the vast control these companies exerted on the market, and the oligarchs could avoid being subject to the ‘righting of privatization’, which the population demanded, and that Putin apparently supported.

Secondly, the State itself moved to increase its stake in some of the most profitable companies in the economy. In the energy sector, it increased its presence in Gazprom, Rosneft, Sibneft, Sakhalin Energy and TNK-BP. These companies were now either completely controlled by the State, such as Gazprom, or had a majority of shares that were property of the State, such as Rosneft and Sibneft, or were subtracted from the properly private sector or from collaboration with foreign companies through partial State ownership and legal escamotages. Essentially, the State was now under control of the most powerful industries in the most profitable sectors of the economy, owing about 50% of the stakes of the oil industry (Philips, 2008). In other key sectors too, State control increased. Rosoboronexport, the state-owned defense equipment company took control of Avtovaz and VSMPO-Avisma, respectively the leading producer of cars in Russia and of titanium in the world. In total, by 2005 the private share in the economy stood as just 65%, a decrease of 5% from the previous years. (OECD, 2006).

This figure is not only a significant blow to the private sector in itself but is particularly worrying since these sectors account for the most profitable in the economy. According to a 2014 statement by the IMF, the State acquisition of strategic assets had brought it to hold almost

70% of the value of the economy in its hands. This statement has not been univocally confirmed but it is evident that even a slighter lower figure would result in significant consequences.

Economically, the availability of a stable and assured stream of resources had a drastic impact on the possibility for development. Being natural resources in high demand and largely available in the country, exports of the latter continued to grow coming to account 65% of total Russian export revenues. Due to the profitability of natural energy exports the government budget consistently stayed on the positive side, with a fiscal surplus of 4.6% of GDP, trend that has been accompanied by a substantial accumulation of foreign currency reserves. Alarmingly, without the revenues from this type of exports the budget would have been in a deficit valuing 4.7% of the GDP. (IMF, 2008). The revenues from the exports of oil and gas alone then had the power to impact the budget by a margin of 10%, an enormous figure. The effect of this over reliance on energy exports had wide ranging effects on the make out of modern-day Russia.

First of all, within the natural resource sector itself the overbearing presence of the State was detrimental. In an industry with almost no private actors and no competition, the necessity to innovate is significantly lower. This effectively meant that all the efforts to improve and differentiate productivity were essentially curtailed and heavily influenced by the active direction of the State. This situation is almost irreversible, as it is impossible for even one of these firms to break free from the mold of the State-controlled sector, especially since the heads of these companies are either closely affiliated with the administration or the board of shareholders includes a substantial number of *siloviki* members. Even if this possibility was to materialize, which is highly unlikely after the Yukos case, the totality of the pipelines and distribution and storage facilities of oil and gas are owned by Gazprom, effectively being subject to a State-owned monopoly.

The impact of the dependency on energy sector rents has also had drastic consequences on the general state of the economy. If the State has a stable source of revenue the chances that it will continue to foster the development of a favorable business environment are significantly lower. This instance has been particularly true in Russia as the Ease of doing business index has decreased over time, reaching an all-time low of 28 in 2019, to slowly recuperate in the following years. This trend is not directly dependent on the natural resource rents per se but derives rather form the disinterest in carrying out difficult reforms aimed at reducing corruption in the judiciary, the taxation agency and the policing and control of enterprises. In general, the productivity of other sectors other than that of natural resources has decreased over time, essentially driving the economy in a state of stagnation, with growth rates of around 0 to 2% in the decade from 2010 to 2020 (World Bank report, 2021). In this situation, fluctuations of oil and gas prices are especially dangerous to the equilibrium of the economy, as they have a significant impact on the state budget. The reliability of the currency, its fluctuations and the ability to guarantee international debt are also amongst the variables that are impacted negatively by the primacy of energy exports, essentially contributing to the structural vulnerability of the economy. (Åslund, 2020)

The availability of natural resources also creates drastic effects on the political environment of the country. The so called 'resource curse' is very much a real phenomenon in Russia, as the soundness of democracy has significantly decreased over time, going hand in hand with the increased reliance on energy exports. (Koshkin, 2017) With its grip firmly tied on the natural resource sector and a poorly performing economy, the State becomes increasingly vested in maintaining the status quo. As the potential to lay a firm foundation for both economic and political dynamism is passed up in favor of the easier path of relying on energy sector rents, the cost of reforms rises over time. The tradeoff is especially high for the political class as it would have to essentially relinquish its control over the resources that maintain the power structure in its leading position. The tendency that emerges instead is the opposite, a strengthening of political and economic control, with the impression that the latter could fend off the prospect of reforms.

This situation is akin to a mechanism already present during Soviet times. As analyzed in the first chapter, the old system was characterized by the phenomenon of *fusion* of the political and the economic elite, which rendered reforms impossible without the risk of jeopardizing the stability of the country. The situation of modern-day Russia is somehow similar as the political elite, a restricted group of oligarchs and the powerful class of the *siloviki* exert an economic and political monopoly. If the management of either of the two were to be reformed, the whole system would come crashing down. The fundamental variable that distinguishes the Soviet and the Russian *fusion*, though, lies in the capacity of the latter. While in Soviet times the phenomenon affected the whole system, meaning the essence of the structure of the State, in modern day Russia its capacity seems to be contained by the concomitant presence of fortuitous factors. Variables such as the specific connotation of Vladimir Putin's style of leadership, the current international order and its political exploitability, and the favorable market for natural resources, all seem to have had a decisive impact on the current *fusion* of Russia's political and economic spheres.

The fundamental conclusion that can be extracted from this specific set of circumstances is that they could disappear without a total overhaul of the system. Recent events have shown that the necessary external pressures, such as the European Union ban on imports of Russian natural resources (2022) and the international condemnation of the invasion of Ukraine, could be sufficient to fatally damage the current political and economic structure of Russia. Internally too the situation seems to have reached the point of breakup. The stagnation that has affected the economy in the last decade, the strain of sanctions that have been imposed since the 2014 invasion of Crimea, the increasing inequality between the rich and the poor and the climate of terror that have characterized Russia in the past years are now generating sufficient discontent with the elites, at least amongst the younger population. There is the chance that if the opportunity represents itself, with the death of Putin potentially, the country will have another chance at overhauling its economy and restructuring its democratic institutions.

Conclusion

This body of work has attempted to answer the question of why Russia's market economy is so peculiar in nature. As it emerged in this paper, trying to pinpoint the precise catalyst that kickstarted the emergence of the current configuration of the economy is almost impossible. The reasons for such difficulty relate primarily to the fact that each country's evolution to the economic organization of its society depend on a set of variables that is specific to its context. Russia is no exception in this regard, but, unlike other nations, it has been the trial ground for the application of economic theory since the end of the XIX century. From the policies of the Tsars to the establishment of the command economy and the transition back to market, Russia has experienced a variety of diametrically different economic organizations, more than any other country in the XX century.

There are numerous inferences that might be drawn from this experience. To begin, one could attempt to study the theory of economic efficiency of the various precepts that have been applied in Russia, whether they were tied to a command or a market economy. Second, the country's experiences during the restructuring and rebirth process that followed the demise of the Soviet Union may provide a reliable measuring baseline for future instances of economic transformation and evolution of struggling economies. Third, the outcomes of the economic policies applied through the XX century could be analyzed in their interaction with the social and institutional background present at the time of their introduction, as in their consequences on the latter.

What emerged more starkly from the survey of Russia's economic history, though, is its uniqueness. Whether its economy was reformed in the direction of plan or market, the developments that emerged as a result were the direct consequence of their insertion in Russia's reality. The question that ought to be asked, then, is whether there is such thing as an economic reality independent from the rest of the variables that take part in creating the society in question. What appeared from this analysis is that it is indeed very hard to analyze the institution of the command economy or the institution of the market in their pure form and then subsequently apply them to the Russian case study. What emerges, on the contrary, is that there is essentially no such thing. As soon as the evolution of Russia in the last decade is organically elaborated, as this work has attempted to do, is evident that regardless of the economic organization of the country, there is an underlying trend that ties together radically different experiences. Defining the essence of this factor is necessarily hard as its nature is practically impossible to pinpoint precisely, but it is still important to note that it is a fundamental variable to take into consideration when attempting to extract deductions from the analysis of Russia's economic history.

The ultimate conclusion that emerges from this work, and under many respects the only certain one, is that regardless of the theoretical soundness of the precepts and reforms applied to the economy, there is no unilateral or correct result. Oftentimes, a framework designed by conscious efforts will be molded by the necessities of those who have real interests and necessity to utilize economic relationships to their own advantage and to guarantee their subsistence. It is not surprising then that the economy of Russia has experienced structural failures as, as soon as the system had reached its capacity to accommodate the needs of the general population, it collapsed and morphed into a new configuration that is indeed shaped from above, and under new rules, but is still subject to the pressures of the precedent one. There is no definite guarantee, then, that the Soviet economy would have survived or that the Putin economy will as long as 'that' specific reform is implemented, since there is no essential formula for ensuring economic success, only one that is well tailored to the possibilities and needs of the whole group of individuals.

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Sommario

Questo elaborato è incentrato sull'analisi della transizione da economia pianificata ad economia di mercato in Russia. L'introduzione si occupa di chiarire le motivazioni per le quali questo tipo di indagine sia utile nel migliorare la comprensione della Russia moderna. I principali punti di interesse sono infatti strettamente legati all'interconnessione fra le capacità dell'economia e le possibilità di materializzare le intenzioni di un paese in politica estera e in politica interna. Nel caso della Russia, che ambisce al ritorno a status di grande potenza, l'analisi dello stato dell'economia è dunque particolarmente utile per ipotizzare i futuri sviluppi in politica estera. Secondo poi, la trasformazione avvenuta in Russia durante il XX secolo è certamente il più drastico esempio di trasformazione dell'economia. Le lezioni che possono essere apprese dall' analisi delle riforme implementate in Russia potrebbe dunque essere utile in luce di altre riforme economiche da implementare in paesi in via di sviluppo. In generale, l'analisi della storia dell'economia della Russia è senza dubbio utile per capire la situazione corrente nel paese, sia politicamente che economicamente.

Il primo capitolo di questo scritto si occupa principalmente di delineare l'evoluzione dell'economia Russa prima della caduta dell'Unione Sovietica nel 1991. Per condurre un'analisi accurata del processo di trasformazione, e delle condizioni che hanno permesso il suo sviluppo, viene analizzata la storia del paese a partire dal periodo degli Zar. La conclusione principale che si evince dallo studio di questo periodo è la peculiare conformazione della società e della divisione in settori dell'economia. Alla fine del XIX secolo la Russia era infatti uno dei pochi paesi in cui persisteva la servitù della gleba. Questa precondizione è sostanzialmente risultata in un lento sviluppo industriale, che ha necessitato l'attuazione di

programmi imposti dall'alto, con lo scopo di stimolare artificialmente le variabili necessarie per l'industrializzazione del paese. Questo scenario è caratteristico della Russia in quanto i paesi occidentali avevano sperimentato un graduale indirizzamento verso la creazione delle condizioni necessarie allo sviluppo industriale. Questa differenza sarà cruciale nel condizionare la politica economica adottata sia da Lenin che da Stalin. La NEP, applicata da Lenin nei primi anni della Russia Sovietica, puntava principalmente a sostenere il settore agricolo, provato dall' abolizione della servitù della gleba e ancora in una fase acerba della sua organizzazione. Il mantenimento di dinamiche di mercato nel settore avrebbe di conseguenza aiutato a supportare l'industrializzazione del paese, garantendo una solida base per la crescita del settore industriale. La politica in questione venne abbandonata per motivi prevalentemente politici da Stalin. A causa della necessità di aumentare le capacità industriali del paese e di conciliare questo obbiettivo con i precetti del comunismo, l'organizzazione economica dell'Unione Sovietica virò verso un sistema propriamente pianificato. L'analisi del primo piano quinquennale è volta a spiegare le caratteristiche salienti di questo tipo di organizzazione economica. In primis, il settore agricolo venne collettivizzato, e divenne totalmente regolato dallo stato. Lo stesso processo avvenne nel settore industriale. Tutti mezzi di produzione divennero di proprietà dell'autorità centrale, che avrebbe regolato anche le quantità e la tipologia di beni da produrre così come le dinamiche della loro distribuzione. L'analisi del sistema pianificato si basa soprattutto sull' influenza che esercita sul comportamento delle imprese. L'ambiente in cui queste ultime operano è in fatti radicalmente differente da quello di un'economia di mercato data l'assenza della domanda e di un sistema di prezzi che la rifletta. In questo scenario, le motivazioni per migliorare e differenziare la produzione sono radicalmente diverse e molto più suscettibili alla dipendenza dallo Stato che è sia il primo investitore sia il responsabile dei guadagni delle aziende. Questo sistema, una volta raggiunto il limite di capitale umano e materiale facilmente utilizzabile, diventa estremamente suscettibile a gravi disfunzioni sistemiche. A causa di queste ultime, al momento della salita al potere di Gorbačëv, la situazione economica del paese era ad un livello di stagnazione, con reale possibilità di gravi perdite. La Perestroika, il programma di riforme avviato dal segretario generale del partito, puntava esattamente a rivitalizzare l'economia del paese. Il metodo utilizzato per giungere a questo risultato si basava prevalentemente sull'introduzione di alcune delle caratteristiche dell'economia di mercato, come il sistema di domanda, in contemporanea con un sistema pianificato dalla capacità ridotta. Le riforme di Gorbačëv non ebbero il risultato sperato e l'economia sovietica durante gli ultimi anni 80 era ormai impossibile da rivitalizzare e plagiata dal caos creato dal piano di riforma. L'ultimo tentativo di ristrutturare l'economia fu la creazione di un piano da attuare in 500 giorni. I contenuti principali di quest'ultimo erano prevalentemente legati allo stabilire un sistema di prezzi di mercato e al privatizzare le proprietà dello stato. L'attuazione di questo programma non avvenne mai a causa di dissensi fra la vecchia leadership sovietica, l'entourage di Gorbačëv e la figura di Yeltsin. Ultimamente, il collasso dell'unione rese qualsiasi tentativo di ristrutturare l'economia pianificata vano.

Dopo la caduta dell'Unione Sovietica, la situazione politica ed economica era particolarmente disastrosa. La leadership di Yeltsin, con l'assistenza di organizzazioni internazionali come l'IMF e il Tesoro americano, decise per la conversione dell'economia a economia di mercato. Le teorie su come attuare questa transizione dipendevano dalla struttura del pensiero economico degli anni 90, improntato sulla teoria neoliberale. Il ruolo dello Stato nella struttura economica doveva essere minimale, e l'economia doveva essere organizzata in base ai principi del libero mercato. La maggior parte degli economisti coinvolti nella transizione condividevano le basi di questo pensiero ma differivano sul ritmo e l'ordine con i quali le riforme fossero da implementare. La leadership russa scelse una rapida implementazione di queste ultime, secondo l'approccio della shock therapy.

Le riforme iniziarono a gennaio del 1992, con la liberalizzazione del sistema di prezzi, causando un'acuta iperinflazione e un disastroso impatto sulla popolazione che perse in poco tempo i suoi risparmi. Questo primo passo verso l'economia di mercato fu seguito dalla stabilizzazione macroeconomica. Quest'ultima si basava sulla ricostruzione del sistema finanziario e monetario. La riforma del sistema di tassazione, la ristrutturazione del rublo, il cambio della politica di credito facevano tutte parte di questa fase della riforma. La liberalizzazione del sistema economico, anche essa parte della creazione dell'economia di mercato, consisteva nella ristrutturazione della competizione fra aziende e in altre misure, fra le quali l'apertura dei mercati esteri. Il passo più importante verso la creazione di un'economia di mercato era però la privatizzazione delle proprietà dello stato. Questo processo avvenne principalmente attraverso un sistema di voucher che consentivano si acquistare quote nelle aziende. Questo sistema venne sfruttato da un selezionato gruppo di persone che divennero i principali proprietari dei più importanti asset del paese. La privatizzazione delle compagnie strategiche, soprattutto nel settore delle risorse naturali, avvenne invece tramite un sistema corrotto tramite il quale importanti oligarchi si appropriarono di esse in cambio della garanzia di ottenere la rielezione di Yeltsin.

Queste riforme, che si estesero fino alla fine del 1994, apparentemente ottennero il risultato sperato, creando un'economia di mercato. Questa impressione di stabilità venne però confutata dalla crisi del 1998, derivata direttamente dagli sforzi di attenersi strettamente alla politica economica liberale. Queste misure soffocarono la fragile ricostruzione delle imprese russe, sostanzialmente danneggiando la possibilità di fare impresa nel paese. Il governo Putin inizialmente si focalizzò sulla ristrutturazione di una buona base per permettere di recuperare le condizioni necessarie per far crescere l'economia. Tuttavia, la necessità di stabilizzare la situazione politica ed economica si concluse con la creazione della corrente situazione. La situazione politica odierna è infatti marcata da gravi tendenze antidemocratiche e da un'economia stagnante. Un grande contributo a questa situazione è dato dalla grande disponibilità di risorse naturali, monopolizzate dallo stato, che permettono il mantenimento di un buon bilancio e bassi livelli di debito, dilazionando così la necessità di attuare delle riforme. La corrente situazione è, ultimamente, il risultato della storia economica del paese e della reazione a piani strutturati di riforma, che, interagendo con la realtà della Russia ha creato la struttura politica ed economica del paese al giorno d'oggi.