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By Yegor Gaidar



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In the early spring of this year the future of the economic reforms in Russia looked not very bright at all. The president's positions were strongly undermined after his losses at the Seventh and the Eighth Congress of People's Deputies. It was evident that President Yeltsin was step by step losing the possibility of promoting his reform policy.

The government was deeply divided over what should be the basic direction of the economic reforms. It tried to resolve the most difficult problems of the Russian economy by printing more money and by trying to freeze prices at the end of 1992. The privatization program was fiercely criticized from all sides. The number of enterprises being privatized was falling every month, from 12,000 in December 1992 to 2,900 in April 1993. The official in charge of the privatization program, Mr. Chubais, was under constant pressure from the parliament and the government calling for abolition of the program. The parliament was discussing the possibility of ending privatization or amending the privatization legislation to make it practically impossible for the program to continue.

The existence of such an unhealthy environment led to the acceleration of inflation. By the beginning of January inflation reached 9 percent a week, which was beyond the technical limits of hyperinflation. The level of instability was incompatible with any prospects for foreign investment in Russia.

So it looked like our opponents were winning the battle. If you had a chance to be present at the Eighth Congress of People's Deputies, you would have seen how content were the faces of our "friends" from the extreme right and the neo-Communist opposition. They were already discussing how they would divide the ministerial portfolios, how they would manage the economy, and other issues of this kind.

No-Confidence Vote. One of the most dangerous moments in the post-World War II history of our country, and probably mankind, came when the Ninth Congress of People's Deputies attempted to oust Yeltsin through a no-confidence vote. In the case of success, the opposition was ready to immediately nominate the new president, Mr. Rutskoi. Mr. Rutskoi was ready to immediately nominate the new prime-minister, whom I would rather not mention; the new prime minister was ready to nominate the new ministers of defense and internal affairs, and the chief of the secret police. At that point it was already unclear whose orders the Russian Army, the police, and the border guards would follow. Since the August 1991 coup attempt it was the moment when we came closest to the outbreak of the civil war.

However, our opponents failed to achieve their goals. The trend was drastically reversed in March and April. Why did it happen?

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In trying to analyze what was the most serious mistake of our opponents, we realize that it was probably the fact that they made very clear to the people of Russia that the nationalist-Communist takeover was a practical reality. The vast majority of Russia's population considered such a development very dangerous, potentially leading to a conflict with the other states in the Commonwealth of Independent States and the entire world. The people realized that the solutions the opposition was offering for Russia's problems were not practical. That understanding created a strong wave of support for President Yeltsin in Moscow during the no-confidence vote, and allowed all pro-reform forces to unite their efforts and to win the referendum both on the first question (support to the President), and on the second question (support to the economic reform program). This was a great surprise to our opponents.

The opposition considered it possible to lose on the first question, "Do you trust President Yeltsin?" And this is why they decided to include the second question, "Do you approve the economic policy of the President and the government of Russia since 1992?" Technically, the second question was invented by *Smena-Novaya Politika*, a parliamentary faction composed mainly of former Young Communist activists and dedicated to undermining the reform process in our country. They specifically designed the second question in a way that made it absolutely impossible for the president to win. When shortly before the referendum I discussed the issue with my friend Garry Kasparov, the world chess champion, he said: "I think that we should not even try to win the second question, because one should never play the matches that are lost from the beginning."

The victory on the second question came as a complete surprise even for me. Practically, the population was asked: "Do you approve the policy that led to the disappearance of the substantial part of your savings? Do you support the policy that led to inflation and price increases? Do you support the policy that put you in danger of unemployment?"

Real Changes. Everybody was absolutely sure that the logical answer would be "No." But it was "Yes." Why? Is it the unexplainable Russian soul that likes to suffer? Maybe. But first of all, it was the result of the real changes in the life of the Russian citizen.

You know that for the press good news is not news. If you look at what the Russian and the Western newspapers write about Russia, you will read a lot about corruption, inflation, instability, and so forth. But you will never read about changes in the everyday life of residents of a small town 500 kilometers away from Moscow.

What was their life like two or three years ago? It would be absolutely impossible to buy something on a free market in this town. The shortages were not part, but rather the essence of the Russian way of life. You would have to travel once in every two weeks to Moscow or to St. Petersburg in order to try to buy something to feed your family. You would have to wait in a line for two or three hours to buy two kilos of terrible salami, or half a kilo of butter. People would take turns going to Moscow, standing in lines, and so on. This lifestyle was so usual that no one bothered to think about its absurdity. We were the only country where it was possible to fly 1,000 miles on a plane in order to buy three kilos of meat. You were considered important if you had some contacts in a retail shop, which effectively was not a shop, but a state office for distribution of goods in short supply. An ordinary Russian person would spend approximately eight hours a week standing in lines. At work, the major topic for discussion would be, "Where can you find something?"

Now all of that disappeared. You don't have to go to Moscow or St. Petersburg; you don't have to bribe the shop attendant—you can simply go to a shop and buy what you need. In this little town, you can now buy products that two or three years ago were accessible only to the high-level nomenklatura—like kiwi or bananas.

Beginning of a Free Market. The second factor is the feeling of enormous new possibilities. The Russian population has become involved in the new ways of economic life. The entrepreneurial spirit after seventy years of communism has proved to be much higher than anyone, including myself, could expect. In early 1992 we issued the presidential decree breaking the state monopoly on trade and making free trade legal. We thought that it would be at least two or three weeks before we would see any results of this decree. In fact, next morning, when I was going to my office on Staraya Square, I noticed an enormous crowd of people on Lubyanka Square, where the KGB headquarters are located. I thought that it was a line for some goods being sold in a state supermarket. All of these people, holding copies of the presidential decree on freedom of trade, were selling something: shoes, bicycles, butter. It looked wild, not very civilized, but this was the beginning of the process of formation of the free market.

Now, quite a substantial part of the Russian population participates in the process of reform. So, when the question was not whether you would like to have higher salaries, lower taxes, and better job security, but whether you would like to go back to the situation that existed two or three years ago, the population was clever enough to say "no."

What do the referendum results mean for the future of Russian economic policy? Those results created quite a different environment for the continuation of the privatization process. While in late April it looked like the privatization program would not survive another few weeks, now it is more or less intact. Serious acceleration of both small-scale and large-scale privatization is inevitable. Now we are selling the shares of approximately 500 Russian companies per month in free auctions. We have started the process of privatization of 17,000 big Russian companies. We have completed privatization of approximately 70,000 small Russian companies. Generally, it is more or less clear that this process cannot be reversed. By the end of 1993 the private sector will be predominant in retail trade, in the service industry, in building materials and light industry, food processing, and machine building. We are approaching the start of the privatization process in the oil and gas industry, coal industry, and transportation. Generally, I hope that by the end of the year 50 percent of Russia's GNP will be produced by the private sector.

Irreversible Step. Of course, Russian private enterprises are very young and unstable. It is only the first step in the installation of a functioning private property mechanism. Nevertheless, the process itself is hardly reversible. It is very difficult now to come to a factory manager or a store owner and to tell him that it was only a joke, and that he is once again being subordinated to the splendid leadership of the district Party committee.

What are the consequences of the referendum in terms of financial stabilization? Of course, you have to take into account political instability. In such times, it is especially difficult to adopt unpopular decisions. For instance, coal prices are being freed only now, even though it was absolutely necessary three months ago. Also, in such situations the government has to increase social expenditures, such as pensions, subsidies to the military, and so on. And we are paying for it by the acceleration of inflation, which in June was 5 percent a week, up from 3 percent a week in April.

However, after the referendum it became possible to strengthen our control over the monetary and the budgetary policy. We were able to start pushing the Central Bank in the direction of increasing the interest rates, which we were not in the position to do between May 1992 and April 1993. Now they are increasing interest rates—from 100 percent to 110 percent, and a few days ago to 120 percent. It is being done slowly; of course, we would prefer much more radical solutions. But at least it shows that the Central Bank is starting to cooperate with the government and to move in the right direction.

For a very long period of time we were trying to stop issuing technical credits to the CIS countries. It was clear that most of the money we were providing ended up at the hard currency markets in Moscow. After the referendum it was finally possible to stop issuing those credits and to convert them into regular export credits with an efficient mechanism of control. This created a possibility of lowering the monthly rates of increase of the money supply, which were down from 22 percent in April to 14 percent in May, and will probably stay on the same or slightly lower level in June.

This means that after the acceleration of inflation in June we have a chance of slowing it down in July and August at least to the level of 15 percent a month. This level will be still very high, but it will be a move in the right direction.

Urgent Priorities. Of course, it is clear that it is almost impossible to stabilize the economy with the parliamentary majority which is doing everything it can to undermine our efforts, to destroy the budget and the monetary policy. So the most urgent problem we are facing is not even economic reform, it is political reform. It is absolutely necessary to hold new parliamentary elections and to ensure the creation of a broad pro-market majority coalition in the next parliament. I would rather not go into the political details of this task, but I can only say that the results of the referendum show us that this task is not impossible to achieve.

The Russian pro-democracy forces, however, will have to prove their ability to unite not only in the times of extreme crisis, when they know that they will be shot the day after they lose. We should create a political network that will ensure Russia's steady progress in creating a civilized society.

What are the long-term economic priorities? First and foremost, it is the battle against inflation. Financial stabilization is absolutely possible, if you follow traditional macroeconomic measures, like the regulation of interest rates and the money supply.

The second most important task is radical legal reform, especially the creation of a sound legal basis for the development of private property. It is unpleasant to confess, but until now we have been unable even to exclude from our Criminal Code the provision that could make any Russian citizen involved in free-market activities liable for criminal prosecution. I am talking about the notion of speculation, which the Criminal Code determines as buying goods for the purpose of re-selling them, and which can still be punished by imprisonment. This makes any normal market activity in Russia legally punishable. Of course, this law is not being enforced, but it does not make Russian entrepreneurs tranquil. Also, Russia urgently needs a new Civil Code, new land legislation, and many other legal developments that would create a healthy and predictable legal environment for the development of Russia's economy.

The third important task is a radical decrease of the role of the government in the Russian economy. Even after the radical cuts in military spending we still have enormous government expenditures. We are spending a terrible amount on housing, grain and other subsidies. The government still bears the burden of all new construction and maintenance of enterprises. Military expenditures are still excessive. So we have a lot to do in terms of making the government smaller and more efficient. One of the priorities should be a tax reform and increasing the share of non-income taxes, such as land and sales taxes.

It is obvious that the reforms in Russia should no longer be based on government investment. It was the case in the eighteenth century during the reforms of Peter the Great; it was the case in the twentieth century during Witte's industrial reforms, and later during Stalin's industrialization. But now the government just cannot afford this type of industrialization. Any real changes in the Russian economy can only be based on private investment. I think I don't have to prove it to this audience.

Our practical choice is very simple. Either we will be able to create the legal, economic, and financial environment in which private investment will create a young and dynamic economy, or we will have long-term stagnation with a low level of foreign investment, increasing unemployment, social pressure, and the danger of the Weimar syndrome. This is a very serious choice, the outcome of which will be very important for the future of Russia and the whole world.

