ECONOMICS WITHOUT HISTORY:
THE EFFORT TO WESTERNIZE THE EAST

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The nations of Eastern Europe and the former Soviet Union, now making the transition from administrative-socialist to market-capitalist economies, have become the favorite testing ground for orthodox Western economic theory. Western economic advisors have collaborated with Eastern economic policy-makers to push for the implementation of programs of economic restructuring designed to build new Western-style capitalist economies from scratch. A striking feature of the economic strategies and policies being pushed in the East is the extent to which they are grounded in neoclassical economic theory and divorced from the historical legacies, and the associated political and social realities, of the societies involved.

In his teaching and his writing, Dan Fusfeld always stressed the importance of the larger historical and institutional context in which economic activity (and economic theorizing) takes place. His perspective is sorely lacking in the currently dominant approach to economic policy in the East. Much as Wolfgang Stolper bemoaned the widespread phenomenon of "Planning Without Facts" in the context of third world economies a generation ago, Dan Fusfeld might well bemoan the equally widespread phenomenon of "Economics Without History" in the erstwhile second world today.

In this paper I propose to explore the kinds of problems that have arisen in the former Soviet Union as a consequence of the hegemony of economic theory over history. I will outline the program of restructuring advocated by most Western theorists for formerly administrative-socialist economies; I will show how this program fails to come to grips with the historical legacy of these societies; and I will discuss the nature of the consequent policy failures. I will draw primarily on the experience of Russia, which illustrates these issues most clearly.

In what follows I will start from the assumption that the goal of economic restructuring in the nations of the former Soviet Union is a viable capitalist market economy of the kind found in North America or Western Europe. I personally favor a democratic form of socialism; but I believe that it is quite unrealistic to expect that such a society can be built on the ruins of Soviet-style administrative socialism. The issue I address in this paper is therefore simply the suitability of Western economic restructuring strategy for the construction of a well-functioning capitalist economy in the former Soviet Union.

I. The Standard Reform Policy Prescription

Western economists have developed a standard policy prescription for restructuring the economies of the East, in the wake of the demise of Communist Party rule and the abandonment of "actually existing socialism." The three principal elements of this prescription are:

1) rapid price liberalization (including the establishment of full currency convertibility at a free-market exchange rate, and the removal of barriers to foreign trade and investment);
2) stringent fiscal and monetary austerity (achieved by sharply reducing government subsidies, entitlement payments and the emission of money and credit);
3) rapid and wholesale privatization of state enterprises, industrial and agricultural, large and small (to shift ownership and control from the public sector to private individuals) — along with the development of stock markets as a putative source of profit-oriented discipline on enterprise managers.

A fourth element is sometimes added to this package (often as an afterthought):

4) the establishment of a permanent social safety net (to protect the population from the worst effects of the dislocations sure to accompany massive economic restructuring and likely to recur periodically also in more mature stages of capitalist economic development).

There are differences of opinion over the pace and the sequence with which these policy reforms need to be carried out, but most Western economists -- especially those associated with international economic organizations (e.g. the World Bank and the IMF) and/or offering advice to reforming governments -- urge rapid and simultaneous movement on all fronts in what is often labeled a "big bang" strategy, or "shock therapy." Reasoning that "you can't jump across a chasm in two leaps," they want rapid and comprehensive measures to achieve macroeconomic stabilization, get most of society's assets into private hands quickly, and then let free markets take care of restructuring enterprises and allocating goods and services.

On this view price liberalization and market-clearing are needed to "get the prices right," so that they reflect scarcity values; markets need to clear -- the sooner the better. Full currency convertibility and the reduction of trade barriers are intended to impose competitive discipline on domestic firms and to attract much-needed foreign investment. Fiscal and monetary austerity is designed to tamp down inflationary pressures and impose hard budget constraints on enterprises; these enterprises, severed from a protective government bureaucracy, will have to make the difficult choices needed for greater efficiency at both the micro and the macro level. Where a rapid sell-off of state enterprises is infeasible, voucher-based mass privatization schemes are often recommended -- to give the general public a stake in the nation's capital stock and a sense of participation in the building of capitalism.

Lip service, at least, is paid to the construction of a new social safety net -- so as to replace the enterprise-based social and welfare services characteristic of actually-existing socialism. But this element of the standard policy prescription clashes with the prescribed fiscal austerity, requiring as it does new government agencies and substantial government outlays. As a result, it tends to be swept under the rug and treated at best as a secondary concern.

Advocates of the standard shock therapy package have in mind the smoothly functioning laissez-faire capitalist system featured in introductory economics textbooks. They presume -- with Adam Smith and so many neoclassical theorists -- that individuals operating independently in a market context will tend to bring about what is best for the society as a whole. Free markets are viewed as a mechanism assuring economic efficiency; markets set up incentives which encourage effort and good work and which penalize idleness and inefficiency, and they allocate resources to their most profitable use.

Once prices have been freed and property rights transferred to private agents, markets are expected to function in formerly socialist societies more or less as they do (or are supposed to do) in contemporary Western capitalist societies. People's economic behavior will soon to conform to that found in well-developed market economies: individuals will show independence
and initiative in seeking to improve their own economic situation, businesses will compete honestly and reliably to lower costs and improve product quality, enterprise managers will be responsive to the wishes of shareholders, and contracts among individuals and businesses will be fairly and fully enforced.

From this perspective, history is largely irrelevant to the design of reform policy. The historical legacy of the societies to be transformed represents an impediment to be swept away as rapidly and as fully as possible. Once the new policies required for market functioning are in place, one can expect the people -- following their natural instincts -- to respond to market forces much as they do in long-standing capitalist societies elsewhere in the world.

II. The Importance of the Institutional Framework

The more thoughtful economic reformers recognize that -- in order to develop a well-functioning capitalist market economy -- it is also necessary to bring about major changes in the institutional environment of the ex-socialist economies. To function effectively a market system must be embedded in institutions that limit problems of malfeasance and, more generally, circumscribe the transactions costs of market operations. What is needed is a comprehensive institutional structure of laws, regulations, and sanctions which channel people's self-seeking drives into activities that create new wealth rather than simply redistributing old wealth.

Moreover, to be efficient a market system must also find ways to limit the incidence and avoid the negative consequences of "market failures" arising from public goods, externalities, and other well-known sources of divergence between private and social benefits and costs. Depending on the context, market failures may best be alleviated by the extension or redefinition of private property rights, by state regulation or intervention, or by voluntary mechanisms of cooperation. But each of these kinds of solution depend on an appropriate legal and institutional framework, which serves to back up private property rights, public programs, or community organizations.

In the absence of the appropriate institutions, market participants will have to devote substantial resources to such non-productive activities as security and contract enforcement; rent-seeking activities will tend to displace productive activities; and private benefits and costs will depart significantly from social benefits and costs. These problems are indeed very prominent in societies emerging from administrative socialism: the Communist-Party-based authority structure bred widespread cynicism and opportunism, and its collapsed disciplinary mechanisms have not yet been replaced by effective alternative institutions. As a result, the costs and risks of doing honest business are very high, and the economic efficiency gains from a decentralized market system are very hard to realize.

To the extent that more constructive patterns of behavior are found in contemporary market economies, it is in considerable part because markets have been embedded in an infrastructure of institutions that encourage such behavior. This infrastructure consists not only of well-defined property rights, but also of a legal and judicial system that enforces contracts and settles business disputes, a regulatory system that limits the accumulation of private economic power and prevents well-placed and/or well-informed people from taking economic advantage of others. In the absence of such institutions, markets will encourage narrowly self-serving, opportunistic and non-cooperative behavior, which will harm the economy as a whole.
Douglas North, probably the most prominent Western economist to take seriously the importance of institutions in economic development, has written (1996):

Economies are poor when institutions are structured in such a way as to produce high costs of transacting in political and economic markets. Creating cooperative frameworks of economic and political impersonal exchange is at the heart of solving problems of societal, political and economic performance. The institutional framework provides the incentive structure that dictates the kinds of skills and knowledge perceived to have the maximum payoff. Relative weights (as between redistributive and productive incentives) are crucial factors in the performance of economies.

Serious advocates of the standard policy prescription outlined in the previous section do insist that institutional reform is an essential prerequisite to success of the policies. They call for new laws and rules to govern property rights, accounting and contracting; the training of accountants, lawyers and public officials who understand these laws and rules; courts and judges who can enforce them; and government regulatory agencies that can limit malfeasance other destructive practices.

These kinds of institutional reforms are of course far more difficult to implement successfully than the economic policies associated with shock therapy. It can readily be understood, however, that without such institutional change, policies which rely on the invisible hand of the market are highly unlikely to achieve their desired effect.

III. The Importance of the Underlying Cultural Environment

If institutional reform were in itself sufficient to assure the success of market-oriented economic reform policies, the task facing ex-socialist societies would at least appear feasible -- if more difficult and more time-consuming than generally assumed. There is, however, yet another layer of the problem to be addressed. Market societies depend for their success not only on market-appropriate infrastructural institutions, but also on market-appropriate values and norms.

To be sure, the market mentality -- Adam Smith's "propensity to truck and barter" -- never disappeared even in the most rigidly administered economy under Communist Party rule, and all kinds of markets have mushroomed in the ex-socialist countries since the administrative-command system collapsed. But it is one thing for myriad transactions to take place between buyers and sellers; it is quite another for such transactions to work "as if by an invisible hand" to coordinate the independent actions of atomistic individuals in such a way that they promote the interest of the economy as a whole. Not only must there be a supportive institutional framework, but to function effectively a market system must be embedded in a general culture of honesty, trust, and willingness to cooperate with others when joint effort is required to achieve desired results.

What is most important to the success of economic reform and/or development efforts based on unleashing the market is that "norms of generalized morality" emerge to sustain the market order. The morality at issue is an other-regarding one that fosters personal honesty and trustworthiness in economic transactions; if it is sufficiently widespread, it encourages trust that others will also keep their word and conduct their business without deceit or fraud. People are
then enabled to cooperate with one another in economic endeavors, confident that each person will do his or her part. Such moral norms are generalized to the extent that they encourage honest, trusting and cooperative behavior with any other person -- not only with those whom one knows personally or with whom one already has some kind of kinship, social or relational bond.

As Jean-Phillipe Platteau has argued, honest and trustworthy behavior is especially likely to be established and sustained on a significant scale in a society where:

1) a large number of people have a preference for honesty and trustworthiness to begin with;
2) they also have sufficient trust in others' predisposition to be honest and trustworthy;
3) the bent toward honesty and trustworthiness is not easily discouraged by bad experiences, and it is easily reinforced by good experiences;
4) cheaters or free riders are subject to strong guilt feelings;
5) honest and trustworthy people are willing to punish breaches of honesty and trust even when their own interests have not been harmed, and when applying the punishment costs them more than they are likely to gain from it.

Fulfillment of these five conditions in any given society depends largely on the prevalence of moral values, which in turn are linked to moral norms.

Values represent what a person considers "right"; norms reflect what "society" considers right. Norms are expectations about people's actions which express a standard of conduct people believe they ought to follow lest they expose themselves to some sanctioning or unpleasant experience. There must be an underlying social consensus to impose sanctions on norm violators. These sanctions can come, in principle, from any one of three sources: (a) the state, (b) other agents, or (c) self-policing. Relying on the state can be very costly; relying on other agents is unlikely to work beyond relatively small groups; this leaves self-policing as an essential basis for adhering to a norm.

Moral norms are rules that are at least partly internalized by agents and prompt people to take others' interests into account; they provide the basis for self-policing. Individuals conform because of a personal attitude about the act itself -- conformity becomes intrinsically rewarding and deviation intrinsically costly, so there is no need for external rewards or sanctions. Moral norms are followed even when violation would be undetected and unsanctioned, because the moral act is valued for its own sake.

The honesty and trust required to make the market work cannot be expected to be assured simply by embedding market relations in dense networks of long-run interpersonal relations and ties. This kind of 'embeddedness' assures honesty and trust by the use of reputation mechanisms; but it does not apply as and when markets transcend family, local and community ties -- as they must to accomplish their full task of developing global impersonal exchange. Not limited-group morality codes, but abstract rules for all, are needed, for it is too costly to generate and communicate the information necessary to sustain the former. By obviating the need for ubiquitous monitoring, and for external rewarding of honesty and/or penalizing of malfeasance, norms of generalized morality ensure low-cost enforcement of the rules of the market game.

Primary socialization (of children by parents) plays a crucial role in the norm generation process, but moral norms are subject to erosion; they form a "social capital" and are liable to depreciation if the cost of honesty and cooperation is high or increasing. The maintenance of
moral norms thus requires more or less continuous reinforcement by secondary socialization (of people in schools, workplaces, etc.). The needed norms are not directly dependent on state enforcement of appropriate conduct and punishment of antisocial behavior; but legal and political institutions must at least be consistent with the cultural context underlying the norms.

It is important to recognize that people's predilection for honesty and trust cannot be expected to come about spontaneously as the market itself expands -- because the appropriate behavior patterns require the rejection of an individual's immediate interest in favor of the longer-term interest. Indeed, Adam Smith himself -- as paraphrased by David McNally (1988, p. 193) -- held that "the only guarantee that commercial relations will not shred the moral fabric of a society is the creation of an institutional framework which sets bounds on [people's] self-interested action." Thus other-regarding values sustaining cooperative behavior make both the market and capitalist enterprises work better, reducing for both firms and society as a whole the costs of monitoring and enforcing terms of transactions -- as individuals internalize public-good considerations and strengthen the conviction that public-good-oriented laws are to be respected and obeyed rather than constantly challenged.

Ultimately the cultural endowment of a society plays a crucial determining role in shaping its moral norms and hence the success or failure of market mechanisms. A government can quickly establish market-supporting institutions (private property rights, laws of contract, etc.), but it cannot create the social/cultural conditions required to make them work effectively by a simple act of will. The market is embedded in society, not the other way round; even a strong ideology of generalized morality diffused by the state has little chance to take root if it falls on a social terrain unable to understand it.

Indeed, if market institutions and market-oriented policies are imposed on an uncongenial cultural fabric, the social structure may actually react by undermining or subverting the functioning of the market -- with unexpected and often undesirable effects. In section V below, we will see how this has happened in contemporary Russia. First, however, we need to examine key elements of the institutional and cultural fabric woven by Soviet-style administrative socialism.

IV. The Historical Legacy of Soviet-style Socialism

The economic base bequeathed by the Communist Party regime in the Soviet Union was in some respects quite favorable to the development of a viable capitalist economy. The favorable features include a very substantial raw material base for industry; an extensive transportation network; a well educated labor force, including many highly-skilled specialists; mastery of certain advanced technologies (notably in military and space-related fields); a huge potential market of consumers; and a heavily urbanized population accustomed to wage labor. On the negative side, the Soviet economy was characterized by a huge and inappropriate structural bias in favor of the military, a depressed agricultural sector dominated by relatively inefficient collective farms, and massive environmental deterioration -- in the form of polluted air and water, toxic wastes, radiation hazards, etc.

Ultimately more significant for the prospects of capitalist development in the former Soviet Union, however, is the framework of institutions, values and expectations which developed under decades of Communist Party rule in the context of Soviet-style administrative
socialism. Some of the most important elements of this institutional and cultural legacy are
detailed below.

First of all, virtually all producers in the Soviet economy were in a position of much
greater dependence on the state for their economic success than those in capitalist economies
have ever been. Producers relied on state enterprises and/or branches of the government
bureaucracy for obtaining resources and inputs, and they often depended on state trading
agencies for locating buyers and delivering their outputs. Managers of both agricultural and
industrial enterprises became used to fulfilling the demands of their administrative superiors, not
to orienting their activities to the demands of purchasers in consumer or producer markets.

Second, people in the Soviet Union were assured of a high level of economic security by
state programs guaranteeing full employment as well as rather extensive welfare benefits (mostly
linked to people's workplaces) -- even though the average material standard of living of the
population was relatively modest. In any transition away from the administrative socialist
system, ex-Soviet citizens are bound to seek assurance that they will not be left unprotected
against uncertainty and insecurity -- e.g., the possibility of losing one's job, or not having the
resources to deal with a medical calamity.

Finally, and most important, the Soviet experience strongly inhibited the development of
precisely the kind of norms of generalized morality which are so important for the effective
functioning of a market economy. In the early decades of the USSR the challenges of building a
new socialist system (and then the military threat to the homeland) inspired many Soviet citizens
to relate to one another in a trustworthy and cooperative manner. As Josef Stalin gained
paramount authority, however, suspicion and even paranoia became a way of life. Stalin's death
led to a reduction in the intensity of mutual distrust, but in subsequent decades cynicism and
opportunism became increasingly prevalent -- in part because of the increasingly visible self-
interest and corruption on the part of highly-placed officials.

During the long "stagnation" (as Russians refer to the years under Leonid Brezhnev's
rule), the only thing that stood in the way of a self-interested free-for-all was party discipline.
When this discipline disappeared with the collapse of the Communist Party, opportunistic and
antisocial behavior became all the more rampant. Examples include the emergence of secretive
clans from the shadows of the second economy to monopolize trade and distribution networks;
the movement of high government officials into lucrative positions into virtually unregulated
new financial organizations such as commercial banks and investment funds; and myriad deals
whereby top Party officials and their friends or favorites gained control of prime real estate and
other assets previously belonging to the Communist Party.

In general, Soviet-style totalitarian politics, rigidly bureaucratic administrative command
in the name of planning, and a system of patronage-based bestowing of privileges in government
agencies and enterprises, had all served to breed the very opposite of norms of generalized
morality. The Soviet regime was fundamentally characterized by the discretionary power of
bureaucrats over subordinates; so reputation effects from personal ties played a critical role in
coordinating economic activity under planning. Vertical relationships between superiors and
subordinates were highly personal, with gifts in exchange for services. The word "mafia" is
aptly used to characterize the networks of personalized relationships which developed -- both
legally and illegally -- under the Soviet system, and with the end of Communist Party rule mafias
have become the prototypical organizational form for economic activity in the former Soviet
Union.
In this context, no shared social ethics or norms of generalized morality can exist. Codes of conduct are governed by limited-group morality, emphasizing strength of ties to kin, friends or close relations. Procedural norms are particularistic, if they apply at all; professional standards are low; rewards and sanctions are based on patronage; and there is a complete absence of a code of conduct based on the principle of abstract equality among individuals. The legacy of corruption and opportunism among government bureaucrats, and the whole culture of patron-client relationships, has made it almost second nature for public officials to serve particular private rather than general public interests. And so the state is regarded -- with considerable justification -- as at best incompetent and at worst thoroughly corrupt.

V. Shock Therapy Meets Russian Reality

Advocates of shock therapy are confident that the implementation of market-promoting policies, and the establishment of market-infrastructural institutions, will work to bring the benefits of a well-functioning market system to societies emerging from Soviet-style socialism. They recognize that it may take time to sweep away what they see as the lingering impediments of the preceding system, but they expect to see -- after an initial period of painful adjustment -- gradually spreading market-appropriate patterns of behavior and corresponding economic progress.

The Russian experience of the last 5 years provides an important and interesting case in point. As the former Russian Republic became the independent Russian Federation in late 1991, President Boris Yeltsin entrusted economic policy-making to his Acting Prime Minister Yegor Gaidar. Gaidar and his associates were strong believers in a shock therapy approach to economic transformation, and in early 1992 they launched a radical economic program to transform the remains of Russia's disintegrating administrative socialist system quickly into a market capitalist economy. Their program involved the freeing up of most prices (including that of the ruble), sharp cutbacks in government spending as well as central bank loans, and a call for rapid privatization of both small and large-scale state enterprises. Privatization of large-scale enterprises was linked to a mass voucher program, in which citizens were enabled to participate in the purchase of enterprise shares through privatization checks distributed gratis by the government. The overall Russian economic restructuring program included all of the basic elements of the standard reform policy prescription outlined in section I above.

By 1996 enormous changes had unquestionably taken place in the Russian economy. The old administrative socialist system of government-dominated resource allocation, government-determined prices and government-controlled enterprises had been largely dismantled and a new market-oriented and private-enterprise-based Russian economy had come into being. Long lines for goods in short supply had virtually disappeared; almost any good or service was available to those who could afford to pay the price. The doors to international economic relations had been opened widely: there was no more government monopoly of foreign trade; the ruble was freely convertible with other currencies and allowed to find its price in foreign exchange markets; and foreign capital investment was welcomed. The vast majority of Russian state enterprises had been privatized (at least formally) -- with the exception of large enterprises in such relatively strategic sectors of the economy as defense and energy products. Close to a third of all Russian citizens held some kind of claim to ownership of productive assets,
whether in the form of shares in large enterprises, shares in funds investing in such enterprises, or joint ownership of a small establishment.

This transformation of the Russian economy took place in a context of deepening economic crisis. By 1996 the aggregate output of the Russian economy, as well as Russian per capita income, were only at about one half of their levels at the beginning of the decade. But supporters of the economic reform program were confident that the worst was over, and that the new Russian capitalist economy was poised for a take-off into a prosperous future.

While appearances certainly suggest that Russia is becoming a Western-style market capitalist society, a closer look at the transformation that has occurred over the past 5 years suggests a rather different conclusion. What is striking is that, in a number of important spheres, the economic reforms have worked out in a different way than initially intended. As we shall see, popular values and expectations rooted in Russian culture have reacted to the shock therapy reforms in such a way as to generate a new economic situation that is neither a normal Western-style capitalist system nor a traditional Soviet-style socialist system.

Privatization of state enterprises

The intent of the Russian privatization program was to restructure enterprise property rights in such a way as to enable outsiders (domestic individual or institutional investors or foreign investors) rather than insiders (enterprise managers and workers) to acquire majority ownership and control of formerly state-owned enterprises. This goal reflected the premise of shock therapy advocates that enterprises (above a relatively small size) can only operate efficiently and dynamically if their management is made responsive to external owners interested solely in profit maximization. Under administrative socialism enterprise management was concerned primarily with fulfilling plan targets and thereby pleasing their superiors in the economic hierarchy, and secondarily with the economic security and social welfare of enterprise workers as well as themselves. Shock therapy enthusiasts wanted to see enterprise managers made accountable not to superior government officials or to their own workers, but to new shareholding and profit-minded owners. In this context managers would presumably not shy away from terminating redundant workers or even from shutting down plants and enterprises which cannot be run at a profit.

To the surprise of many of the reformers most active in promoting the Russian voucher-based privatization process, a substantial majority of privatized enterprises -- both small-scale and large-scale -- have ended up not under new external ownership, but under predominantly insider ownership. Enterprise workers typically hold the largest fraction of ownership shares in the new joint-stock companies, while managers in practice exercise control over major management decisions -- partly by representing worker interests in their traditional paternalistic way and partly by inducing worker shareholders into supporting management interests. It might well be more accurate to speak of the "commercialization" rather than the "privatization" of former state enterprises. What has happened, in the main, is that state-owned and centrally-planned enterprises have been turned into legally independent companies owned and controlled by former managers and worker collective leaders.

The predominance of insider control of privatized enterprises in Russia reflects in part the underlying cultural and political reality that the Russian people strongly value stability and desire security. Far from conforming to the Western capitalist norm, the pattern of manager control of
newly privatized Russian enterprises represent a continuation of a trend in property structure shifts which began in the early 1990s (in the old Soviet Union) with "spontaneous privatization." Since the late 1980s under Mikhail Gorbachev, Russian enterprise managers have been seeking greater autonomy from outside control; and they have been able to make use of the privatization process to enhance and consolidate their autonomy amid a disintegrating political order and a chaotic economic system. If anything, the pattern of Russian privatization has ended up strengthening rather than weakening managerial prerogatives and managerial paternalism.

Instead of stimulating productive new capital formation, the Russian privatization process has actually served to reduce real investment in industrial enterprises -- by breaking the link between control over real assets and control over investment flows. In the Soviet system both were controlled by state. After privatization, managerial teams strengthened their control over real assets -- while commercial banks gained control of investment flows. These banks are reluctant to supply adequate credit for investment in real asset formation because the imperfect system of contract enforcement -- in an overall context of underdeveloped norms of generalized morality -- makes credit supply to enterprises highly risky. Thus much Russian bank capital has been going to less risky short-term commercial activities -- e.g., to finance domestic and international trade and distribution.

Industrial management behavior

In the old Soviet system, and indeed throughout the years of perestroika up to the demise of the Soviet Union, the priorities of industrial managers were jobs, wages, housing and social services (for themselves and their workers). In the new order marked by voucher-based privatization, Russian managers are showing somewhat less concern for these objectives and somewhat more concern for the bottom line. Yet competition is limited, there is still much reliance on state subsidies, and there is as yet no credible threat of bankruptcy. The key to the economic success of an enterprise -- whether private or public -- is usually access to ruble credits, access to dollar credits, and/or access to foreign markets; and all of these depend heavily on political contacts.

Industrial enterprise managers, together with worker collective leaders, remain most anxious to assure the survival of the enterprise and to maintain the economic security of its workers; they are far less interested in increasing the return to capital via lean-and-mean restructuring. Although the radical reformers in the Yeltsin administration paid at least lip service to the importance of dealing with problems of unemployment, their overall economic strategy (including sharp cuts in government spending) raised great doubt about their desire and/or ability to compensate dismissed employees for their loss of employment and enterprise-based social services. Thus it has done little or nothing to relieve enterprise managers of the implicit obligation to keep on providing employment and social services to their workers.

A rapid change in enterprise management orientation is very hard to achieve in Russia, and it may even be counter-productive. It is hard to achieve because enterprise management involves a behavioral pattern deeply embedded in the culture of the society -- a culture where one cannot count on a stranger to be honest or trustworthy. Management styles in Russia will change only as and when the culture itself evolves. Even if a rapid switch to a much more profit-oriented enterprise management style could be achieved, it might well be damaging to the
Russian economy -- for in the contemporary environment of underdeveloped market institutions, what is profitable is far from what is economically efficient or socially desirable.

Indeed, rapid reorganization, streamlining and/or liquidation of existing enterprises in order to show a profit could result in the loss of potentially valuable elements of existing capital stock as well as valuable skills and know-how of the current labor force. And a drive for profits would be likely to result in the abandonment of many social services provided previously by state-owned enterprises, since such services do not generally yield a profit. This would help enterprise-level profits, but it would lead to a much greater demand for state-provided social services at a time when the government is already short of funds and is also trying unsuccessfully to meet many other high priority needs.

Agricultural reform

In the agricultural sector the Russian Government under Boris Yeltsin has brought about a significant number of institutional and policy changes, consistent with the overall effort to build a private-enterprise-based market-oriented economy. For political reasons land reform has proceeded somewhat more slowly than enterprise reform; indeed, to this day much of the Russian land is not freely and easily bought and sold. However, a multiplicity of land tenure forms now exist in the countryside; many kinds of lease arrangements are possible, and several hundred thousand completely private small farms have sprung up.

The dominant state and collective farms of the Soviet era have been reorganized, in a process whereby members could opt to remain in a more independent form of agricultural cooperative or leave the cooperative with a proportionate share of land and property. Vertical ties between the center and the remaining cooperatives (which still account for the lion's share of agricultural land and production) have been restructured to give the latter much more autonomy; a substantial share of agricultural output must still be delivered to the state, but at prices much closer to market-clearing levels.

Yet in spite of the enactment of many pro-market agricultural economic policies, and the development of all kinds of new rural institutions, much remains as before in the Russian countryside. First of all, collective forms of farm organization have remained much more popular than expected. Indeed, many of the old Soviet-style collective and state farms have changed little more than their name and their formal juridical status. Only a small minority of rural residents have opted to become independent farmers. There has simply not been -- and there does not seem likely to be in the foreseeable future -- any mass decollectivization of Russian agriculture.

Why have the pro-capitalist and pro-market policy changes not had a greater effect? The main reason appears to be the continuation of powerful social and cultural forces in Russian rural life, which impart an enormous conservatism to the agricultural sector. For several generations collective farms have served as a source of community and security for rural Russians, assuring members and their families of work, food, health care, education, pensions, and access to a variety of social and cultural amenities. To leave such an environment is to renounce a social and cultural milieu that provided participants with a meaningful identity. It is also economically very risky -- especially when one cannot count on norms of generalized morality to inform market transactions.
Efforts at macroeconomic stabilization

The old Soviet economic system was of course dominated by the state, and it was precisely this state domination that the Russian economic reformers who gained decision-making power in early 1992 viewed as the source of most of the nation's economic problems. The shock therapy enthusiasts thus considered it vital to break -- once and for all -- the power of the state over the Russian economy, in order to render irreversible the transformation from administrative socialism to market capitalism.

To be sure, the disintegration of Russian central state power was already well underway during the latter years of the Gorbachev regime. After the collapse of the Soviet Union, however, the process accelerated. Partly by default, partly by deliberate policy, political power was very substantially diffused from the center to regions and localities; and effective economic power was diffused from government ministries to former state enterprises and to local government agencies.

From the perspective of the Russian economic reformers, this kind of rejection of the historical legacy was all to the good. Private enterprise in a free market context could be expected to do far more efficiently what the old Soviet state had tried to accomplish in the economic sphere. The main economic task of the Russian Central Government was to cut its expenditures sharply, in order to bring them into line with tax revenues and balance the budget; while the Russian Central Bank was to restrict the growth of the money supply, in order further to dampen inflationary pressures.

For the most part, however, Russian government macroeconomic stabilization efforts have been quite unsuccessful; fiscal and monetary collapse has been averted largely by a substantial infusion of credits from international institutions. The sources of the continuing macroeconomic stabilization problems are various, but the Soviet historical and cultural legacy looms important in two key respects.

First of all, central state revenues have plummeted, while popular demand for continued public spending -- in such areas as public sector wages, pensions, health and education -- have made it politically impossible to cut expenditures anywhere near as much as advocated by shock therapists. Continuing and politically effective demand for state spending to directly benefit citizens is the current expression of a long-standing Russian expectation that the state will take care of the basic needs of the people. The inadequacy of government revenues can be attributed not only to the loss of authority of the Russian Central Government over regional and local government agencies, but also to the lack of a Russian tradition of tax payment compliance on the part of enterprise managers and wage-and-salary earners. Under the Soviet system, most revenues were raised in the form of enterprise turnover taxes linked to state ownership of enterprises and strict central control of prices and incomes.

In the monetary arena, efforts by the Russian Central Bank to curtail money supply growth have frequently been frustrated by politically effective demands on the part of failing enterprises for enough credit to stay in business. Where and when sufficient credits for this purpose have not been forthcoming, curtailment of public money supply growth has been countered by growth in private money supply -- in the form of inter-enterprise debt. Instead of forcing failing firms to declare bankruptcy, as in well-functioning market economies, the inability of many Russian enterprises to pay their bills has led to voluntary growth of mutual indebtedness among all enterprises. In this way old patterns of real resource flows continue, as they used to in Soviet days, independently of enterprise balance sheet considerations.
The contradictions of a rapid transition

For shock therapists, great speed and great scope are essential to successful economic reform. One cannot be too brutal in sweeping away the old system in order to make way for the new. There will be more pain in the short run, but more gain in the long run, if the reform process bulldozes ahead; indeed, if it fails to do so, there is a great risk that it will become completely mired in the mud of the old regime and fail to move forward at all.

One implication of this approach -- clearly in evidence in contemporary Russia -- is that the new market economy develops in a context of enormous social and economic dislocation. As people in various walks of life scramble to find their footing in a world of new policies and changing institutions, some are much luckier or much more adept than others, and inequalities of all kinds grow rapidly. Indeed, the distribution of income in Russia has surged from relatively equal to highly unequal by international standards. The sudden dismantling of the old order has greatly increased the scope for corruption; and the historical legacy of nomenklatura privilege and a shadow economy has made groups of mafiosi -- much more often than dynamic new entrepreneurs -- the greatest beneficiaries of economic reform.

The dislocation and inequality that have characterized the rapid Russian transition have had a number of counter-productive effects on the establishment of a viable and effective market economy. They have strengthened the long-standing orientation of most ordinary Russians -- agricultural and industrial and service workers -- to value stability and security over the kind of risk and enterprise called for in a market system. They have led to a powerful political backlash against market-oriented reform, which has clearly influenced in a very conservative direction the campaigns of virtually all candidates for the Russian Duma in December 1995 and the Russian Presidency in June 1996.

Finally, and perhaps most importantly in the long run, the "wild" environment in which capitalism and the market have come to Russia has made it all the more difficult to develop the cultural norms of generalized morality which are so crucial to a viable and effective market economy. Indeed, if anything, there has been regress in this respect. Criminality and racketeering in Russian business, trade and finance has surged. The Soviet legacy of personal clientelism has been reinforced by the current weakness of Russian government authorities, and the continuing opportunism of many government officials in the context of underdeveloped market-regulatory institutions.

As a result, conditions have been created in Russia in which unscrupulous and powerful or well-connected individuals and groups can amass vast fortunes through semi-legal and illegal operations. Many potentially productive entrepreneurs -- both domestic and foreign -- have been discouraged by the high costs and risks of doing honest business in Russia. Indeed, to be trusting and cooperative in Russia now is more likely to make one a sucker than a contributor to general economic welfare. Extremely self-regarding values, widespread distrust of others, and indeed outright crime are all too evident in Russia today.

To overcome the damaging cultural legacy of Communist Party rule was bound to be a daunting task and a very long-run process under the best of circumstances -- one which would call for exceptional moral as well as political leadership. The nature of the transition to a market capitalism underway in contemporary Russia has only made this an even greater challenge for the future.
VI. Conclusion

In Russia in 1918 a group of "young intellectuals, with little grip on the realities of administration," undertook an "elemental chaotic proletarian nationalization from below." They were trying to bring about a socialist revolution in the absence of a strong proletariat and of a socialist culture. Their Marxist background should have imbued them with an understanding of how the historical legacy of Tsarist Russia would constrain the prospective road to socialism. In the fire of revolution and civil war, however, the Bolsheviks cast caution to the winds and sought immediately to bring about a totally new order.

Some 74 years later another group of young Russian intellectuals, with little grip on the realities of administration, initiated what well might be described as an "elemental chaotic bourgeois denationalization from above." They were trying to bring about a capitalist revolution in the absence of a strong bourgeoisie and of a capitalist culture. Their neoclassical economic background (and that of their Western advisers) gave them no sense of the historical legacy of Soviet-style socialism and how it would constrain any prospective transition to capitalism.

In both these cases there were much more promising alternative strategies open to the revolutionaries -- strategies whose common denominator is gradualism. The Bolsheviks did turn to a gradualist economic approach when they launched the New Economic Policy (NEP) in the early 1920s. The NEP was successful in restoring the nation's economic health; but it could not reverse and ultimately succumbed to the logic of authoritarian centralism which marked the early Bolshevik years.

The pro-capitalist revolutionaries of the early 1990s could have opted for a gradual process of economic reform -- one involving progressive liberalization of prices and opening up of the economy, a more nuanced approach to macroeconomic stabilization, and a slower and more equitable process of privatization which would encourage diverse forms of enterprise ownership and control. Such an approach would have eased the pain of the transition, prevented the massive polarization of Russian society between the few who have struck it rich and the many who have plunged into poverty, and it would have encouraged rather than discouraged the development of norms of generalized morality. To adopt such a gradualist strategy at the present time (1996) would almost surely be too late; unfortunately, much of the damage of precipitate action has already been done.

The Bolshevik revolution ended up in Stalinism -- a tragic parody of socialist ideals. The danger now is that the efforts of Boris Yeltsin's team of economic reformers will end up in a form of authoritarian corporatism -- an equally tragic parody of capitalist ideals.
FOOTNOTES

1. For my advocacy of democratic socialism, see Weisskopf (1993); for my skepticism about its feasibility in the East, see Weisskopf (1995).

2. My characterization of the standard Western policy prescription is close to that of Murrell (1995).

3. This term is due to Platteau (1994), whose analysis has strongly influenced my own.

4. The embeddedness thesis has been advanced by Granovetter (1985).

5. If moral norms are backed by strongly-held religious beliefs, involving an all-knowing God, they may be sustained without secondary socialization even under the most adverse earthly circumstances.


7. See Kotz (1996), chapter 9, for a more detailed description of the Russian shock therapy program.

8. According to the Statisticheskoe Obozrenie (1995, No. 4, p. 9), published by the Russian State Statistical Committee (Goskomstat), Russian GDP declined by 47% from 1990 to 1995. Since the Russian population actually declined in the early 1990s (see below), per capita GDP fell by slightly less than 47%.

9. That there is no credible threat of bankruptcy is of course quite inconsistent with the intent of the shock therapy approach to economic restructuring; but it reflects one of many ways in which the Russian economic and social system, so influenced by its Soviet legacy, has resisted in unanticipated ways the imposition of shock therapy policies.


REFERENCES


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