



The Struggle for a
Free Economy
and Society in
Russia

YEGOR GAIDAR

THE SIR RONALD TROTTER LECTURE

2000

NEW ZEALAND BUSINESS ROUNDTABLE



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The Sir Ronald Trotter Lecture

SIR RONALD TROTTER was the first chairman of the New Zealand Business Roundtable in its present form, a position he held from 1985 to 1990.

Among his many other roles he has been chief executive and chairman of Fletcher Challenge Limited, chairman of the Steering Committee of the 1984 Economic Summit, a director of the Reserve Bank of New Zealand, chairman of the State-owned Enterprises Advisory Committee, chairman of Telecom Corporation, chairman of the National Interim Provider Board, a chairman or director of several major New Zealand and Australian companies, and chairman of the board of the Museum of New Zealand Te Papa Tongarewa.

He was knighted in 1985 for services to business.

This lecture was instituted in 1995 by the New Zealand Business Roundtable to mark Sir Ronald Trotter's many contributions to public affairs in New Zealand. It is given annually by a distinguished international speaker on a major topic of public policy.

The sixth Sir Ronald Trotter Lecture was given by Dr Yegor Gaidar at the Auckland Centra Hotel in Auckland on Wednesday 25 October 2000.

I





Yegor Gaidar



EGOR GAIDAR was born in 1956 in Moscow. He graduated from Moscow State University in 1973 with a first-degree diploma and received a PhD in economics in 1990.

Between 1980 and 1987 he was a researcher at Moscow State University and two economic institutes, and from 1987 to 1990 editor and head of the economic department at the *Kommunist* magazine and *Pravda* daily newspaper.

In November 1991, following the election of Boris Yeltsin as president, Dr Gaidar was appointed minister of finance and economy and deputy head of the Russian government.

In February 1992 he became first deputy prime minister and minister of finance, and from June to December of 1992 served as acting prime minister of Russia.

Since 1992 he has been director of the Institute of Economics in Transition.

In September 1993 Dr Gaidar became minister of economy. He led the Democratic Choice party to victory in the December 1993 parliamentary elections. He remains a member of the Duma, having been re-elected at the 1999 elections.

Dr Gaidar is married with three children.





Introduction by
Roger Kerr
executive director
New Zealand Business
Roundtable



ON BEHALF of the New Zealand Business Roundtable it is my very pleasant duty to introduce our guest speaker, Dr Yegor Gaidar.

This is the sixth annual Sir Ronald Trotter Lecture. The series was inaugurated in 1995 to recognise Sir Ron's role as the Business Roundtable's founding chairman and his many contributions to business and public affairs in New Zealand. We are delighted that Sir Ron is with us this evening.

The purpose of the lecture is to feature an outstanding international speaker on a major topic of public policy. In past years we have had speakers from the United States, Britain, Italy and Australia. It is a privilege to welcome on this occasion a distinguished visitor from Russia.

Dr Gaidar was born in Moscow in 1956. His grandfather was a very famous Soviet writer and his father was a military correspondent for *Pravda*. Dr Gaidar recalled in an interview the first words his teacher spoke to him: "How could you write so badly when your grandfather was so great a writer?". As a schoolboy, he studied in Yugoslavia and Cuba. Encouraged by his father, he went on to study economics, and gained a PhD from Moscow State University.



Working first in the academic world and research institutes, Dr Gaidar has been at the centre of Russia's reform movement since the mid-1980s. When communism collapsed and Boris Yeltsin assumed power in October 1991, Dr Gaidar was thrust into the role of masterminding the transition from a centrally planned economic system to a market economy. This was a mindboggling task: the economy was in chaos, the system of commands from Moscow had broken down, and prices, markets and a functioning monetary system had to be created from the ground up. Hardship was inescapable as prices were freed, subsidies were cut, efforts were made to tighten monetary policy and balance the budget, and state enterprises were privatised. This was not a recipe for political popularity.

In February 1992 Dr Gaidar became first deputy prime minister and minister of finance. From June to December of 1992 he was acting prime minister of Russia. Most of Russia's major reforms were begun in this period. Between 1993 and 1995 he led the largest faction in the Duma, Democratic Choice, and served as minister of economy in 1993.

Dr Gaidar resigned from office at the beginning of 1994 in disagreement with the direction of the Chernomyrdin government. Since then he has continued as director of the Institute of Economics in Transition and is a member of the Russian parliament. He remains the most outspoken liberal in Russia. Unlike some other reformers, his reputation and integrity remain intact. He has opposed the war in Chechnya. In the 2000 presidential election he gave his support to Vladimir Putin and has been actively involved in drafting the current economic programme.

The creation of a market economy in Russia, and the virtual impossibility of a return to communism, owe more to Yegor Gaidar than to anybody else, except perhaps Boris Yeltsin. Those of us who have visited Russia in recent years cannot help but be inspired by the new sense of hope and freedom, despite all the difficulties, and the reintegration of a great country with all its history and culture with the rest of the world.



Tonight we have the privilege of hearing at first hand Russia's leading advocate of economic liberalism. Dr Gaidar will reflect both on the country's reform progress over the last decade and on the more universal features of the struggle to build a free society and a modern market economy. I have no doubt that much of what he has to say will resonate with our experiences in New Zealand.

Ladies and gentlemen, please welcome Dr Yegor Gaidar.







The Struggle for a Free Economy and Society in Russia

Introduction: beware of oversimplifications

The world contains an enormous quantity of information. Since one's capacity for absorbing and dealing with information is limited, one must constantly use very simplified versions of the world. If one asked a normal, intelligent, and well-informed Russian what they knew about recent economic policy in New Zealand, at best they would say that 15 years ago New Zealand embarked on a path of radical liberal reforms; that New Zealand kept implementing that agenda for the whole period; that something has gone wrong; that the New Zealand dollar has fallen sharply; and that now the country is seeking some different way forward.

New Zealanders themselves know the real history of that period. They know that it contained a variety of governments with a variety of policies. Sometimes there were very consistent reforms. At other times reform stalled. And sometimes policies were inconsistent or downright poor. Informed New Zealanders are only too well aware that the true story of New Zealand economic policy during the last 15 years is much more complicated than the caricature offered.

Outsiders have a similarly unclear and incomplete picture of developments in Russia. If one asked a normal, intelligent, and well-informed American or European what they knew about Russian



economic policy over the last eight years, they would probably say that during this period Russia has tried to implement a policy of radical liberal reforms; that this policy is not well suited to Russian traditions; that Russia is consequently in considerable difficulty; and that it is teetering on the brink of social and political upheaval. But such a simplistic formula is largely wrong. Russia never did have eight years of consistent economic policy of any kind. Despite that, the Russian economy is in a less parlous state than generally supposed. Admittedly one can never rule out further social and political upheaval.

The well-informed American or European might also say that in Russia there is a great deal of crime; much corruption; problems with the oligarchs; poverty; and the Chechen war. All of these problems do exist. But if these are the only facts one knows about Russia, one is seriously misinformed about life there. To some extent this is analogous to the distorted picture of America, and of the west generally, given to Soviet citizens in the days of the cold war. According to Soviet propaganda the United States had mafia, corruption, the military-industrial complex, oppressed Afro-Americans, and trade unions fighting for the interests of working people. All these statements were true. But if one knew only those particular facts about the United States, one had a very distorted picture.

Thus despite Russia's serious problems, in December 1999 a parliamentary election was held. After eight years of very difficult transition, not a single party, including the communists, would have stood a chance of being elected to parliament by campaigning on a platform of abolishing markets, eliminating private property and restoring socialism. That is no longer a realistic political possibility. Russians have become accustomed to regarding markets as normal.

Russia is currently a rapidly growing country. Gross domestic product is expected to increase by around 8 percent this year, industrial production by 10 percent and investment by 20 percent. Russia is running a budget surplus of 2.3 percent this year, and the government has obtained the full support of parliament to adopt a very conservative



and sensible budget for the coming year. Currency reserves more than doubled during the first nine months of the year 2000/01. Moreover, the government began to implement a radical programme of liberal reforms this year.

These are real facts about Russia, and somehow all of the facts – the good and the bad – must be fitted together in making a balanced assessment of this large, diverse, and not very simple society.

But it still needs to be explained why the transition from socialism in Russia was so difficult. Why did the attempts to build a free society and a market economy in Russia take so much effort? Why did ordinary Russians pay such a high price? Why were the results of reform disappointing for a long period of time? And why was the path to a market economy easier in China or in Eastern Europe than in Russia?

The basic answer to these questions is that socialism had its deepest roots in Russia. There are clear continuities between Soviet Communism and all previous Russian history. Communism was not imposed on Russia by the conquering armies of some foreign power, but grew up through a process of internal multi-national evolution. Moreover, three generations of Russians were born, educated and lived under the system. All of their previous experiences were destroyed to a much greater extent than in any other country.

The logic of totalitarian power

At the beginning of the 1990s, economic reform was not the main factor driving social developments in Russia. To a large extent, liberalisation of the Russian economy came as the result of a profound political revolution that destroyed the totalitarian communist regimes, both in Russia and in Eastern Europe. The people who formed the Solidarity trade union in Poland, or who dismantled the Berlin Wall in East Germany, or who organised the demonstrations in Prague that led to the Velvet Revolution, or who started the pro-independence movements in the Baltic States, or who eventually demonstrated, 200,000-strong, in Moscow, were not thinking about concrete economic



policy issues. They were not advocates of either monetarist or Keynesian solutions, or devotees of public choice theory. They were seeking above all the right to be free – to run their own lives, to be able to travel where they wanted, choose the government they wanted, read the books they wanted, and have many other basic liberties. They wanted an end to totalitarianism.

Real socialism, as opposed to imagined socialism or the textbook socialism of some thinkers, is, above all, totalitarian rule. A functioning socialist society and socialist economy requires a very strong, relatively well-organised, extremely cruel, totalitarian political regime. Such a regime eliminates the complicated, delicate mechanisms that evolved over a period of centuries to create the modern market economy. It eliminates civil society because civil society is itself an enormous threat to totalitarian control. Those who lived under socialist rule sometimes found it difficult to understand some of the extremes to which the regime went. For instance, 15 years ago it was easy for a Soviet citizen to lose their job and even to go to prison, not because of any overt attempt to undermine the regime, but simply for starting to offer ballet courses without consulting the local party committee. It looked like a disproportionate reaction: why should the regime care about something as harmless as ballet courses? But they saw its importance. The ruling elite understood that if they allowed civil society to operate in the field of ballet courses, or any other area of spontaneous social organisation, it would begin to undermine the basic concept of the socialist state. Thus no activity in civil society would be permitted without the clear order and participation of the socialist power. Allow ballet courses and a few years later the Berlin Wall will fall and the Velvet Revolution will occur in Prague.

Another key feature of a socialist regime is that power is strongly integrated in the day-to-day operations of the economy. People who never had the chance to live in a non-market society find it difficult to understand the importance of markets for the conveniences of



everyday life. They never had to wait in a queue for two or three hours just to buy bread, or to wait five hours for a chance to buy a refrigerator. They do not appreciate the importance in a non-market society of having good connections with the shopkeeper, who can tell them whether there will be an opportunity to buy shoes that day, and when the goods will be delivered to the shop.

Markets seem so normal that one scarcely needs to care about them. But in a country where markets have been eliminated from the normal functioning of society, bread never arrives in a shop simply as a result of somebody having an interest in delivering it. It is very difficult to imagine how life is organised under these conditions. But without such an appreciation, it is hard to understand why it is so difficult to organise civil society, a market economy, and a functioning democracy, after socialism.

In the absence of markets, an economy can only operate if it is integrated in a huge bureaucratic organisation that penetrates all segments of society, and through which orders are given to enterprises about what should be produced, where it should be delivered, where they must obtain the components of production, and numerous other matters. And it is not enough to give orders: they must also be imposed. It needs to be demonstrated that if a collective farm chairman is not delivering grain to the state procurement agency, they will not be a collective farm chairman much longer. They may even end up in prison, or shot. Only with a clear understanding that failure to behave, or to obey orders, will meet with immediate punishment can the non-market economy function in a modern, comprehensive, industrial society.

Thus totalitarian power is not only the centre of socialist society, it is also the centre of the day-to-day functioning of the non-market economy. Such a system is easy to manage when the tasks confronting it are very simple. One can extract all the grain from the countryside. If a few million peasants die from hunger, that is regarded as their



problem. One can export the grain to America and Europe, import machinery, and compel the sons of the peasants to create infrastructure. These are simple tasks. And back in the age of coal and iron one could even industrialise a country very rapidly under this system.

In contrast, modern civil society, market economies and democratic government are very complex phenomena. They involve a delicate interplay in which individual producers and consumers choose what to do, and people enter into various other associations voluntarily. The mechanisms of civil society emerged slowly through a long period of evolution dating back to the European Middle Ages, in to which many additional institutions were added through the centuries. Private property with a long history of being legitimately held; enforceable contracts; the rule of law; an independent judiciary; and control by civil society over the government bureaucracy – all these emerged only over a long period of time. They cannot be created in a day or a year.

Civil society and a developed market economy can be compared to an aquarium containing a variety of attractive fish. It is very beautiful. It is complex in its organisation, but also very delicate. The temperature must be kept exactly right, as must the light. Because it is so delicate, the system is difficult to preserve and easy to kill. Thus it is easy to destroy the market economy and civil society: one simply boils the aquarium, as if one is making fish soup. And that is what socialism does. It murders a few million people; intimidates the remainder; introduces strong secret police, present in any cell of society; and by eliminating civil society and the market economy creates a bureaucracy that runs the entire economy. Thus socialism makes boiled fish soup out of an aquarium. It is very simple: boiled fish soup is not as delicate as an aquarium. For instance, one need not care about the savings rate that might emerge from civil society; the savings rate will be determined by the government. One need not care about the share of government expenditure and taxation in the economy that the various processes of civil society might bring about, if left to operate. That too will be



determined by the government. And anyone who disagrees will not be in a position to express their opinion.

The system collapses

The collapse of this system in Russia did not start with aspirations for market economics on the part of the few scholars who thought about the possibility of market-oriented reforms in Russia. The regime was undermined above all by a growing lack of faith among the communist elite in its own ideas. In the 1930s the members of that elite were certain they had the answers to all the important questions. They believed they knew how societies should be organised, that socialism was the great idea for the future, and that the Soviet Union would win the economic competition with the capitalist countries.

In the mid-eighties they lost that confidence. The elite still pretended they knew the way forward, but they no longer had any serious internal belief. They were confronted with evident decline. An increasing amount of resources had been withdrawn from agriculture, and private agriculture had been virtually eliminated. The Soviet economy was huge but inefficient. It was failing to match the leading market democracies in science and technology. It was uncompetitive on world markets and highly dependent on oil exports. Oil had financed the Soviet military build-up of the seventies and early eighties, but by the mid-eighties oil prices were falling. The Soviet Union was also losing the confidence of the leading industrial democracies. There was a feeling that the system had exhausted all its resources.

Thus the Soviet elites lost their sense of direction. They also lost the confidence that was vital to a system whose essence was the ability to use unlimited force against those perceived as a threat. They lost the feeling that they had the right to coerce. There had also been deep changes to society. To an extent, the socialist regime was the victim of its own limited success. Though the process had been very cruel, and tens of millions had paid with their lives, the regime had nonetheless



managed to industrialise the Soviet Union and Eastern Europe in a relatively short period of time. But running a totalitarian system is much easier when the population is largely uneducated and illiterate, and where 80 percent of the people are in the agricultural economy, than when the population is 80 percent urban, literate, well educated, and domiciled in big cities for two generations. For this group of people, it is much harder to understand why those set over them should have the right to decide how they should live. There is quite a strong connection between the desire for democracy and the level of a country's social and economic development. And by the mid-eighties, citizens of the Soviet empire no longer seriously believed in their rulers.

Thus two forces came together: loss of the belief by the elite that they had a right to rule; and loss of the belief in society that they needed to be ruled – that things should be that way. Lenin, who understood revolutions very well, once described the revolutionary situation as one in which "those who are above are unable, and those who are below are unwilling". That was exactly the situation throughout the Soviet empire in the mid-eighties. The combination of the two forces, in conjunction with the first, very small-scale, liberalisation steps by Gorbachev, created the critical mass and energy that led to the destruction of the socialist political regime – first in the Baltics and Eastern Europe, then in the very centre of the empire. Once people began agitating widely for freedom and democracy, and once it became evident that the ruling elite no longer had the capacity to use unlimited violence, the totalitarian regime effectively ended.

When in August 1991 a junta kidnapped Mikhail Gorbachev and tried to crush violently the pro-democratic movement in Russia, the result had been prefigured in many earlier revolutions throughout history. The coup leaders could not find a single regiment that would be loyal to them. Not a single general would take the responsibility to shoot at the Muscovites who had massed to defend the Russian government and the Yeltsin White House. They were confronted with tens of thousands of people who simply would not accept the coup.



That was the moment when the Soviet Union and the communist regime crashed. It looked stable and robust only a few days before. But on 22 August 1991 it was non-existent. The instruments of the regime had crumbled with it. The essence of the regime had been the communist party and the Committee of State Security (KGB). On 22 August one could see very frightened KGB officers burning papers in the KGB building. My Friends for Democratic Russia were occupying the building of the communist party central committee, and attempting to defend those working there from a crowd whose designs on them were far from friendly.

The days of 21 and 22 August are still very vivid in my mind. It was evident that the essence of the regime no longer existed. It was an exhilarating time but also an extremely anxious one.

Preventing starvation and creating markets

History reveals that revolutions are rarely uniformly splendid experiences. Revolutionary times are typically dangerous and unpleasant. They are characterised by weak and inefficient government, high crime rates, violence and enormous risk. To some extent any revolution is the fault of the previous regime and the old elites, who fail to reform a system peacefully. But that is little consolation once the revolution gains momentum. At that point one cannot say: "This revolution is too dangerous. Let us stop now". There is little point in crying out to the mob running to storm the Bastille: "Wait! Are you absolutely sure that France has all the institutions needed for running an efficient democracy? Let us stop and analyse whether all the preconditions are in place". Revolutions have their own logic and momentum.

During the next few days in Russia the district party committees all over the country stopped functioning. There would have been little point in exclaiming: "Stop! Are you absolutely sure all these committees need to be abolished? How will the economy actually function over the next few weeks?". The communist party had *been* the



state: no other state operated. For those who understood how totalitarian power had operated in the day-to-day life of Russia, it was not difficult to predict what would happen next.

The week after the coup the quantity of grain delivered to the state procurement agencies fell to a fifth of its previous level. Previously a collective farm chairman had delivered up grain through fear of the district party committee and the KGB. Now there was no district party committee or KGB. Why should they now give their grain to the procurement agencies for money that was worthless? Were they stupid? And if there is no grain in the grain storage facilities, and if markets are non-existent, how will food come to Moscow, St Petersburg, and all the other cities? Who will feed millions of Russians? The same question could be asked about all the other sectors of the economy. Who will deliver coal to the electricity stations if people are no longer being ordered to do it? And if they fail to deliver the coal, where will the electricity come from? Where will Russian factories get their raw materials? Where will farms get their fertiliser?

A political revolution had destroyed the centre of the socialist political and economic system – totalitarian power. And a revolution in a totalitarian regime destroys the day-to-day functioning of economic life. The economy begins to collapse rapidly. In Russia there was a very serious threat of a humanitarian catastrophe – in a country full of nuclear weapons. In these circumstances one cannot adopt a wait-and-see attitude, read Hayek and Adam Smith, wonder whether to develop the economy in an American way or European way or New Zealand way, then make up one's mind as to what should be done. One is immediately confronted with pressing and unpleasant choices. To avoid a social catastrophe, when there is sufficient grain to feed the big cities only until February and the harvest is in July, one has essentially only two options.

One option is to bring back some type of administrative system for distributing grain. At its most extreme such an approach could involve re-enacting the policy of the Bolsheviks during the civil war: send the



military to the countryside; extract the grain from the peasants by force; then bring it to the cities for distribution. That was an option for the first Russian democratic government, which I had the chance to lead in autumn 1991. My own view, shared by the vast majority of my colleagues, was that such a solution was absolutely out of the question. It was both politically inadvisable and a practical impossibility in the Russia of 1991.

The other option is to create markets. Markets had not been in existence in Russia for 75 years. They were not known to the fathers of those in economic life, or even to their grandfathers. Even the most basic institutions for markets were absent. The Soviet Union had practically stopped functioning on 22 August 1991. There was no longer a central bank but 15 central banks, all printing the same currency. Thus the Ukraine central bank was continuing to issue rouble credits, adding to inflation. It is extremely difficult to make sensible economic policy in that situation. It would take six months just to perform the technical work of devising a banking system. There was no customs agency, because customs agencies in the Baltic States were no longer taking orders from the union customs agencies, and there were no customs agencies on the borders with the Baltic States. There was no normal tax-collecting office. There was no treasury system. There was no judiciary. And there were no market traditions. On top of all that, Russia had inherited a huge foreign debt, and foreign currency reserves were exhausted. Yet still one needed to make markets work somehow, because any other option seemed worse.

Thus in practical terms the economic policy promoted by the government, late in 1991 and early 1992, was less than ideological. The government was confronted with a dangerous reality in which it needed to make markets work, without all the pre-conditions for markets and with the enormous risk that markets would not in fact function. All the policies – price liberalisation, the introduction of rouble convertibility on the current account, the attempt to divide the rouble zone and introduce control over the Central Bank of Russia, the



introduction of very low tariffs, the opening up of the economy, the decree concerning freedom of trade, the first privatisations, and other initiatives – were above all connected with these circumstances.

During 1991–1992 Russia did manage to avert the crisis of the first stage of post-socialist transition. It came at a very high price, with very inefficient solutions. But the problem of food supply to the big cities was solved, and the danger of a humanitarian catastrophe averted. The overall economic situation stabilised. There were big cuts to military expenditure at this time. Market-clearing prices, a convertible currency and certain market institutions began to function after a fashion, and became accepted developments in Russia.

Political crisis averted and an uneasy equilibrium established

One of the most important decisions taken by Boris Yeltsin in the whole of his presidency was the decision to dissolve the Soviet Union without quarrelling with the other republics over borders. Thus Russia let Ukraine become an independent country rather than pursue negotiations over whether it should return the Crimea. Kazakhstan was set free without arguing over whether the northern territories should be returned. Yeltsin and I were often criticised for the Ukraine agreement. It was claimed that before letting Ukraine go, Russia should have negotiated over border issues. But we have all seen what happened in post-communist Yugoslavia. Ten years ago, if anybody with knowledge of both the Soviet Union and Yugoslavia had been asked which country would be likely to have the worst ethnic and nationalist tensions over the next decade, they would have said the Soviet Union. But there has been much less conflict and bloodshed in the former Soviet Union because Russia, unlike Serbia, was willing to allow the peaceful break-up of the federation.

In my view the decision to dissolve the Soviet empire was absolutely correct and created the possibility of a comparatively peaceful transition. But dissolving the Soviet Union left Russia without a



functioning state, because Russia never *had* a practically functioning state under the old regime. Thus the two years between the end of 1991 and 1993 were filled with the struggle of the Russian parliament for control over the state. There were extremely weak governments. There were tensions and contradictions between Moscow and the regions. And there were power struggles between the presidency and the Supreme Soviet (Russia's upper house). Throughout this period there was also serious conflict over the direction of reform. The problem with revolutions is that they inevitably run into harsh reality, including economic reality.

When people were overturning communist power they had only a limited understanding of the difficulties involved in reconstructing normal civil society after the downfall of communism. Socialism had made boiled fish soup from the aquarium: that was easy. Russians were now confronted with the task of creating the aquarium from the boiled fish soup – a much more complicated exercise. A market economy is all about traditions and institutions. One cannot just wish these into existence.

In autumn 1993 there were serious clashes over the direction of Russia. These came to a head on 3 and 4 October. Nazi-oriented reactionaries and armed detachments took over the Moscow city government, and were storming the city centre. This was one of the most dangerous moments in our modern history.

Many people who saw the tanks shooting at the Russian parliament do not know the real story of those two days. The police, for instance, were virtually non-existent during the crisis. The military would not fulfil any of Yeltsin's orders until 50,000 Muscovites had gathered on Tverskaya Street, in front of the Moscow city Duma, and it was made clear that the Yelstin forces were prepared if necessary to distribute military weapons to them – to deal with the Nazis ourselves. Only then did the military begin to act. That was the moment when Russia was closest to full-scale civil war, but the government was able to come out victorious.



The October crisis was followed by elections in December 1993 and by the referendum that adopted the Russian constitution. At this point Russia had a new constitution, a president with extended powers, and a parliament in which the government had substantial support. In my view, this was finally the time to end crisis management and begin implementing the policies necessary to achieve a well-functioning market economy: reform the very inefficient tax system, stabilise the budget, fight inflation vigorously, reform social security, tackle the problems of the military agencies, promote the land court, legislate to protect property rights, put in place bankruptcy law and undertake many other initiatives.

The problem was that Russians were very tired of the difficult and indeed traumatic changes of the previous two years. Even their leaders were tired. The president was tired. There was a moment when I tried to persuade Yeltsin that this was the opportunity we had both been fighting for all these years – that we could not lose if we pushed ahead. But it was evident that he was not prepared. Neither were the government and the major part of the elite. The feeling was, "We are tired of all the changes. Let us slow down".

A new equilibrium of political forces was emerging. In the course of the economic reforms there had been substantial winners and losers among social groups. That is inevitable in any period of major change, good or bad. Some industries had become better off and some worse off. Those individuals who had improved their position tended to be young, urban and well educated. Those who had lost out were older, rural, and poorly educated. The winners were generally prepared to support more change but the losers hankered after the old days and saw further change as a threat.

When confronted with similar problems, other Eastern European countries had a major advantage over Russia. In most of them there was a general consensus among their elites about the desired direction of change. They wanted to be part of Europe and to be accepted into the European Union. They understood the requirements for entry and



the implications for budgets, monetary policy, respect for property rights, and other areas of policy. Their political parties would quarrel at election time and employ various populist tactics but after the election there was a consensus about broad directions. In Russia there was no such consensus. Elites were extremely divided between those who genuinely wanted to transform Russia into a modern market democracy and those who dreamed about re-establishing the empire.

The result was a semi-equilibrium in which the reformers were unable to push forward and their opponents were unable to roll anything back. There was zero practical progress. This semi-equilibrium was the most important feature of Russian politics between 1994 and 1998. Thus it is wrong to describe Russia as going through eight years of liberal market reforms. There was a short burst of reform. Then the period between the end of 1993 and 1998 saw a lack of any consistent policies at all. The majority in parliament were generally anti-reform, and defeated all legislative reform attempts. State obligations were constantly pushed higher. And throughout this period property rights were poorly protected.

In this semi-equilibrium markets were functioning after a fashion: the goods were in the shops; there were no shortages; and the currency was convertible. Russians even gained some additional experience with market mechanisms. But it was a semi-market, because it still lacked institutions that were important to the efficient functioning of a market economy. For instance there was no proper bankruptcy legislation. A Russian could run a very poorly managed enterprise and accumulate financial obligations. But they would not go bankrupt; inefficiency was locked into the system.

Normally functioning markets have tough disciplines. If one cannot run one's enterprise profitably, one is out of business. Gone now from Russia was the tight discipline of socialism: the order from above; party control; fear of the KGB. But it had not yet been replaced with the tough disciplines of the marketplace. There was private enterprise but not private financial responsibility. Thus there was a very low level of



discipline throughout the Russian economy. The currency was very unstable. Property rights existed but were not fully protected. That led to capital flight, because nobody felt sure that their property would not be confiscated once again. The government was running a huge budget deficit, and borrowing on both the domestic and international markets. This unstable semi-equilibrium, in which markets were functioning but very inefficiently, was the source of the major problems of Russian society, including inequality, corruption and economic stagnation.

The communists again demonstrate their incapacity and incompetence

This semi-equilibrium could not last forever. Either Russia had to go back to the socialist economy or go forward to implement the necessary liberal reforms. The government's inability to devise any real solutions was the source of mounting dangers. The financial crisis of 1998 – the huge devaluation of the rouble, the default on rouble-denominated obligations, the crisis of the banking system – was an inevitable result of inconsistent economic policy. This crisis led to very serious problems in Russia. But as so often happens in history, the result was surprising.

The crisis led to the formation of the first communist-controlled government since 1991. It was headed by Mr Primakov, who had formerly been head of Russian intelligence, and before that a member of the Politbureau of the Communist Party. The senior deputy prime minister in charge of the economy was Mr Maslyukov, who had also been a Politbureau member and chairman of the state planning committee. Many of his colleagues were appointed to key positions in the government. It appeared that market liberals had lost the battle – that policies of greater central control would return. And indeed the programme presented by the government was extremely bad: the introduction of price controls; the elimination of rouble convertibility; the printing of a great deal more money; and much more. Many people genuinely expected the government to implement this programme.



But now the communists were in power rather than simply criticising from the sidelines. They were suddenly responsible for the results of their policies. Within two months it became clear that they were very afraid to implement anything from their own programme. They understood the consequences. They realised that almost overnight a shortage economy would return. Three-hour queues for bread and butter would reappear. Rouble non-convertability would have big repercussions for foreign trade. And with the increased experience of Russians in markets, the communists understood how society would react to the reappearance of shortages and to rouble non-convertability. They saw it as extremely dangerous politically.

Thus by December 1998, three months after the communist government was formed, it was evident to anybody who understood the processes of government in Russia that the communists were completely at a loss. They were afraid to implement their own programme and they did not have any other programme. They were bereft both of ideas and of practical steps to take. They began to negotiate with the International Monetary Fund (IMF) – not very efficiently. And then they began once again to implement the programmes of the previous government.

The fact that the communists, on gaining power, were unprepared and unwilling to implement their own programme was a major turning point in the development of modern Russia. If it is impossible to go backward, then probably there is no other option but to go forward. Indeed it became clear to the elites in society that the only way to deal effectively with the more negative aspects of the semi-market economy was through progressing the reforms. That was the most important factor behind the success of the pro-reform parties in the 1999 election and the formation of a pro-reform government in May 2000. The 1999 election was regarded as fairly conducted by all the participants. At that election not even the communist party was arguing for the abolition of private property and a return to socialism. While there are quarrels



over the type of market economy Russia should have, the market itself has become an accepted reality.

A new agenda for reform

The new government formed in May 2000 has embarked on a comprehensive programme of economic reforms. This time the reforms are based on Russia's existing political institutions. There is a huge amount to do, if Russia is to become an efficient modern economy. But the government has conceived a sensible programme from the beginning, and begun to implement it.

The essence of the programme is the creation of a good business climate in Russia. Currently the climate for investment is poor. Sustainable growth will not come simply from hoping that the future path of oil prices will be kind to Russia. Substantial additional investment will be required. Moreover, the state will not have the resources to undertake much investment itself. Russia already has a high savings rate – around 25 percent of gross domestic product (GDP). Unfortunately, investment is only 15 percent of GDP, since 10 percent of savings is invested abroad.

This is not because Russians know how to use money better in Switzerland than in Russia. They know the investment environment in Russia better than they know the Swiss environment. They have been exporting capital from Russia for many reasons: political instability; fears that the history of Lenin's New Economic Policy of the 1920s would be repeated; a very bad tax system; weak protection of property rights in the courts; a poorly functioning judiciary; financial instability; and a badly performing banking system. This capital flight needs to be reversed. There are unlikely to be large numbers of foreigners hurrying to invest in Russia until Russians themselves are withdrawing money from their own foreign economy in the Swiss banks, and bringing that money home.



The government has a simple goal – to create the pre-conditions to reverse the capital flow. With the election of Putin, greater political stability has proved an important step in creating a good investment environment. But many more problems need to be addressed.

The government began first with tax reform. The Russian tax system was not untypical in that it was very badly designed. It was very complicated. Some taxpayers faced very high marginal tax rates, which pushed many of them into the black economy. There were an enormous number of loopholes allowing others to avoid tax altogether. Some groups were having to shoulder the burden of financing the pension fund, the medical insurance fund and the social security fund. Thus wage and salary earners caught in the tax net could easily find themselves paying personal income tax at a marginal rate of 50 percent, even at a very low income level.

In form the income tax system was progressive: rates went from 13 percent to 30 percent, leaving aside social security. But in reality it was regressive. It was widely understood that many of those working for oil companies, banks, and small-scale commercial enterprises were paying no tax at all. Insurance schemes and interest rate deposit schemes made tax avoidance perfectly legal. Those paying personal income tax included teachers, doctors, workers in the cultural industries and people employed in the big state enterprises.

One could pretend this system was socially just. But it would be foolish to imagine people would be very law-abiding in respect of tax obligations under such a regime. The new government took a pragmatic approach. It decided to include all the social contributions in a single tax base, taxed at source, imposed on everyone without exemptions, with a single tax rate of 13 percent but with deductions for those on low incomes. Under this policy the tax system will at least stop being regressive and marginal tax rates will be greatly reduced.

It was not an easy solution. But when this measure was going through parliament, the reformers had some powerful political



arguments. The very rich were paying zero taxes. We said to our opponents: "If you care about social justice, then let us first close the loopholes, such as the interest deposit schemes. If you are interested in doing that directly, then we too might be interested. But if you are unprepared to do that, let us first introduce a single tax rate. Then at some time in the future we might move in another direction". The government was brave enough to bring in the single tax rate. Thus a tax code eliminating revenue-based taxes, and introducing a single social tax and a single profit tax, was adopted by the Duma in July 2000 and will be in force from 1 January 2001.

The second important issue tackled by the government was the implementation of federal law. Russia can only function successfully as a democracy if it is organised as a federal state. But Russia is a young state and a very young federation. Power in Moscow has been ill-defined. The regional elites have regarded it as unnecessary to respect federal legislation. Thus the federal government could pass a law, but nobody knew how this law would apply in the regions. Regional governors were even immune from any legal responsibility under the law. The president or the government could do nothing if the federal laws were not being upheld.

Investment and business confidence were seriously hampered while the government was unable to deal with the problem. Consequently changes to the federation that substantially increased the power of the centre to implement federal legislation, and that undermined the power of the governors to avoid that legislation, were key steps towards a better business climate. The financial power of the federation has been strengthened. The devolution of personal income tax collection to the regions has also been a step in the right direction.

The reforms to taxation and to the federal structure were the two most important struggles of the summer. There is still a huge agenda ahead. Labour relationships need to be reformed. The labour court dates from the Soviet era and has no connection with any market reality. It



is out of touch, with the result that large areas of the labour relationship have in practice moved beyond regulatory oversight. Social support is extremely poorly targeted. Eighty percent of the money spent on the social problems of a relatively poor country goes to families who are not poor. The Russian oligarchs, such as the notorious tycoon Berezovsky, had many privileges under the law. Means-testing was only applied for the first time this summer. There is also much to be done to strengthen property rights. Private property on land needs to be legally secured so that normal, civilised land turnover can take place. Minority property rights need to be better protected.

Thus there is much to be done to make Russia a properly functioning, efficient market economy. We are only at the very beginning of the road. The reformers are influenced, not by ideology, but by an understanding of the real condition and potential of Russian government and society. If a country has an incorrupt bureaucracy it might be reasonable to discuss whether more regulation or less regulation is the better option. But for a variety of reasons, Russia does not have such a bureaucracy. Even with the best possible policy, it is unlikely to acquire this type of bureaucracy quickly – at least during the next decade. In these circumstances, discussions about introducing elaborate new regulations that give bureaucrats greater discretionary powers effectively constitute discussions about the quantity of bribes that will be extracted by the bureaucracy.

Thus principles such as deregulation and greater transparency do not stem from dogmatism, but from a genuine knowledge of Russian society. In urging further cuts in state expenditure, one is recognising the level of taxation acceptable to this particular country. Going beyond that level will not bring additional tax revenue, but increased tax avoidance and a growing black economy. Whether or not Putin is a genuine believer in a market economy, pragmatic considerations such as these are constantly pushing Russia in one direction. In the end, those responsible for Russia's development have no other practical choice if they genuinely wish to advance the interests of Russians.



Conclusion: please do not boil the aquarium again

The task for the reformers remains enormous. The transition from socialism in Russia has been particularly traumatic because the inheritance left by the previous regime was extraordinarily difficult. It is always easy to make boiled fish soup out of an aquarium. Reinventing civil society involves making the aquarium out of boiled fish soup. That has been the task confronting policy makers in Russia these past eight years, and it is the task still before them. At least policy is now moving in the right direction. The first steps are bringing results.

Russia and New Zealand are very different societies with very different histories, traditions and institutions. One is reluctant to draw any lessons for New Zealand from Russia's experience. But the following observation is perhaps relevant. Often left-wing intellectuals in western countries say to me: "The version of socialism tried in Russia was not proper socialism. Good socialism has never been attempted anywhere. Thus you cannot claim that socialism does not work. Perhaps one day good socialism will be tried somewhere, and it will be splendid".

I respond by saying, "Dear friends, perhaps you are right. I would not completely rule out the possibility. I only ask this. When you perform the next socialist experiment, *please* do not try it on my country again. Find some other country – perhaps your own".

As I have come to like New Zealand in the course of my visit, I also hope that the next socialist experiment will not be tried here.



Questions

An American feminist writer described the fall of the Berlin Wall as the first feminist revolution: nobody got killed and everybody went shopping afterwards. My question is: Russia had political freedom before economic freedom, whereas China is trying to have economic freedom before political freedom. Which would you prefer?

Everything must come in its own time. Often that question is put to me in these terms: "The Chinese were clever to begin with economic liberalisation. Having achieved a market economy they will be in a position to liberalise politically, some time in the future. By contrast Gorbachev was well-intentioned but foolish. He began with political liberalisation and landed Russia in an enormous economic shambles".

This argument betrays a strange understanding of practical life. It is as though one is sitting in a restaurant, choosing from a menu, and wondering: "Do I want the steak well done or medium? Should I have political liberalisation after market reforms or before?" – as though this were a problem of choice. It is as though in New Zealand you were confronted with some difficult economic problems, and somebody said: "The totalitarian regime has its advantages. Let us introduce it for a time. Then, when we solve our economic problems, we can turn back to democracy". A nice idea, but no intelligent political architect would want to implement it.



The question of whether the Soviet Union could follow the Chinese path of reform might have been sensible if one were discussing the Soviet Union of the late fifties and early sixties. The problem was that by the eighties the Soviet Union had become too rich and developed a country. China was confronted with the limits of socialist growth in the mid-seventies, when socialism was still young and 80 percent of the population was still in agriculture. Many were illiterate, or at best uneducated. It was possible to organise the exit from a socialist economic system under autocratic control.

But to be on this path one needs to be able to be prepared for a Tiananmen Square massacre. The Chinese leadership could pursue that path while the Soviet leadership could not, because in Russia 80 percent of the people lived in the cities, most were well educated, and they had lived under socialism for three generations. That is an enormous difference. Thus the route taken was not the free choice of the various elites but rather a problem of the timing of the transition. To follow the Chinese path one must start leaving socialism at a much earlier stage.

You said that up until a few days prior to the collapse of communism in Russia, the system seemed to be stable. Then it just melted down. Was there some event in the 1980s, or even well before then, that made it clear to you that the system could not survive much longer?

There were few events as such. If you had asked me in 1985 what would happen, I would have said that the system would probably survive for the next 20 years. It would experience increased inefficiency and other economic problems, but not a revolution. Revolutions are very dynamic. They come unexpectedly, and then they have considerable energy and momentum. By around late-1988 I was fairly certain the Soviet Union was facing a catastrophe. There were a variety of reasons: extremely bad economic policy; huge budget deficits; worsening economic conditions; increased support for pro-independence movements in the Baltic States; instability in Eastern Europe; lack of



confidence in the elites about their ability to govern. I believed there was a serious possibility the entire system would fall apart. By 1990 I saw it as inevitable.

Given what you have told us about the difficulty of transition in Russia, why is Gorbachev's reputation so low? Even if his vision was flawed, it would seem that at least he made a very important start.

Gorbachev certainly has a place in history, and he did a great deal to make democracy and freedom in Russia possible. But the Russian people have the right to evaluate their own politicians in their own way. In the 1996 presidential elections Gorbachev received 0.5 percent of the votes. There are a variety of reasons for this outcome and I do not pretend to know all of them. But consider Boris Yeltsin. For all his problems and weaknesses, Yeltsin was an extremely tough and effective Russian politician, with a good understanding of public feeling and public support. Gorbachev never had that. He could manoeuvre, he tried various tactics to implement his policies, but he was never a public politician.

And frankly, what should be the general perception of a president who managed to unify Germany in a way that left Russia 40 billion dollars in debt to Germany? That legacy is not very easy to sell to the Russian electorate.

Could you elaborate on your definition of civil society and comment on the re-emergence of the church in Russia, and its impact on the family? Is that a contributing factor to the re-establishment of civil society?

For me civil society is all those social organisations that spring up independently of the institutions of the state. Civil society in this sense was certainly repressed in all socialist countries, but to a greater extent in the Soviet Union than in most others. For instance, the Polish transition was made easier because an element of civil society remained even under socialist rule, including the Catholic church. In Russia civil society was non-existent during communist rule. The Russian Orthodox



church was under strict political control, and could not then be regarded as an element of civil society.

After the collapse of communism various institutions of civil society did emerge, but they needed time to develop. That also applies to the Russian Orthodox church. Its influence has increased considerably since the fall of communism. But the church is a very complex institution; there are different forces at work within it. Some members of the church are connected to the previous regime. Others are more open in their attitudes, and more oriented towards a wider civil society. Thus the Russian Orthodox church is part of Russian society and is evolving with that society.

We are all full of admiration for your achievements, and for the reforms made in Russia, even at the risk of the reformers' lives. What is likely to happen in Europe with the enlargement of the European Union? Also, what will happen to the Russian mafia as the economy is freed up? Will their potential for corruption be reduced?

On the question of European enlargement, potential member states are currently engaged in delicate negotiations. These negotiations are mostly driven not by big ideas but by the need to accommodate all the different interests in the European Union. Potential entrants are more or less prepared to observe the conditions imposed on them. Sometimes negotiations are comparatively easy, as in the case of Slovenia. Sometimes for a variety of reasons it is more difficult to reach agreement, as with Poland. But the general process of enlargement will certainly go on. Managing the new entrants will inevitably create additional problems for Europe, but it will not prevent enlargement.

The interesting question concerns the limits of an enlarged European Union. Should Bulgaria be included in the European Union? Should Romania? Is Ukraine a potential entrant? What will be the long-term relationship between the European Union and Russia? Russian membership of the European Union does not appear to be a



realistic possibility over the next two decades. But since Europe is Russia's biggest trading partner, it is very important to have a good trading and political relationship with Europe. There is increased interest in Europe in having a good long-term relationship with Russia – especially during this period of sharply higher oil prices.

In respect of the mafia, a variety of social phenomena can be described as 'mafia' when speaking about any country, whether it be the United States, Italy or Russia. There are three different problems. One is the usual problem of organised crime – drug trafficking, drug use, prostitution and so on. This is a serious problem in Russia. To some extent it is connected to the collapse of communism. For instance drug use was very limited under the Soviet regime. But it was limited because the borders were closed, and because there were very strong secret police with a representative in every social organisation. Now with open borders, and without an all-powerful secret police, Russia must somehow deal with the problems of drug trafficking and drug use.

Another problem is the use of various criminal organisations to enforce contracts. That was mainly a phenomenon of the early stages of the transition – the years 1991 to 1994. The court system was poorly functioning or non-existent. An organisation would have problems enforcing a contract. Rather than going to court, it would hire some strongman to enforce the contract. Thus the explosion of these mafia-type organisations was in part a reaction to the inability of the state to impose contract law. But people get tired of other people being shot, even if they are members of the criminal underworld. They understand that if one's partner is shot today they themselves could be shot tomorrow. Thus even in the mid-nineties the big mafia-type organisations began hiring good lawyers to go through contracts, and find out whether the client was right or wrong. Then they even began to wait until the court had made its decision, and only took the contract when the court had ruled in favour of their client. Now with a functioning court system, the need for the service is receding. The mafia



remain a problem, but on a much smaller scale than at the beginning of the nineties.

A final problem, which is not strictly a mafia problem, concerns the oligarchs and the corruption in state administration. It is not drugs or contract fulfilment; they are not shooting at each other. However, the administration of the state is being manipulated. The key to solving this problem is to strengthen the state: make the rules of the game more transparent, and increase the ability of the government to enforce them. Here too there has been progress. The importance and influence of the oligarchs has been radically diminished since the years 1996–1998.

Clearly Russia has come a long way: I understand government spending is now down to around 35 percent of GDP, which is similar to central government spending here. What do you say to those who argue there is a third way, and how much further does one go to finish the drive to a market economy?

Generally I agree with my friend Vaclav Klaus, former prime minister of the Czech Republic. He said that there is a third way. It is the way to the third world.

Do you believe all countries, including New Zealand, could benefit from a low, flat rate of personal income tax?

I often get very tired of experts coming to Russia knowing nothing of local circumstances, and trying to explain what should be done there. Thus I would not wish to tell New Zealanders what should happen in your country in any specific area of policy, including taxation. In the circumstances applying in Russia, a flat income tax seemed a sensible solution. It removed the genuinely regressive aspects of the system, and created the conditions under which a great deal of economic activity would shift from the black economy to the legal economy.



When and how did you personally become supportive of the market economy?

I studied the Soviet economy and attempted to understand how it functioned. I concluded that it had absolutely no future, that it had exhausted its potential during industrialisation, that the problems were growing, and that it was impossible to resolve them in the framework of the socialist regime. My belief in free markets was not based on some ideological prejudice. It came from understanding what was needed for Russia, and the alternative economic policies that were available.

After the collapse of the Soviet Union many experts and organisations from the West offered assistance of various types, including the IMF with money and Harvard University with programmes for economic reform. The British government also offered expertise, both in the former Soviet Union and elsewhere in Eastern Europe. Were any of these of any particular benefit, or would Russia have been better off without them?

The role of international advisers and experts was limited in the Russian transition. There is an interesting misperception about the role of advisers, particularly among many in academia. According to Joseph Stiglitz, who was chief economist at the World Bank, the most important task for a reforming government is to choose the right economic advisers. Then of course it is the task of the advisers to tell the government what to do. Those with some experience in the practical implementation of economic policy will probably agree that this is an extremely unrealistic view.

Of course experts were instrumental in helping in many important technical areas where Russian expertise in a market economy was limited. The national accounts are one example. Russian statistics were based on a different system, and Russia simply did not have enough experts to work through the concepts involved in constructing national



accounts. The technical help provided by the IMF in establishing a system of public finances was also very useful. Thus in many very concrete tasks foreign assistance was positive, especially when it was closely incorporated into the practical work of the Russian government and Russian specialists.

But there is another side to it. Hundreds of international specialists have visited Russia for a week, come to my office, asked me what happens in Russia, told me "you need to balance the budget, control inflation and increase protection of property rights", then left in the direction of London or some other place, imagining they had told me something new. This type of advice was not as helpful. Generally the quality of cooperation between Russia and the outside world has improved. Assistance is now better targeted and more integrated with the work of Russian agencies. It is technical help; the international experts do not expect the Russian government simply to do everything they suggest.

Earlier this year in the Caucasus region I met many highly skilled and qualified people who were no longer able to work in their former occupations. They included chemical engineers and teachers. They often traced the source of their problem to perestroika, and many seemed to believe things were better under Joseph Stalin. There must be a poor use of human capital at the moment. Will these people be able to use their skills to the full in the years to come, and how long might that take?

Many of those skilled people are adaptable. One's skills do not come only from formal education. Skills are also demonstrated by a capacity to adapt. One can have an apparently satisfactory formal education but if one is unable to adapt to changing conditions, this suggests that the education was probably not as good as it seemed. In Russia an enormous number of well-qualified people graduate from good universities in



subjects such as applied mathematics and physics, for which there is a huge demand. They are able to adapt very easily to a changing job market. But many well-educated Russians somehow believe or hope that the system, and the circumstances, for which they were educated will somehow return, whether under Stalin or somebody else. I can assure you this will not happen.

As a human rights commissioner, I would like to know about human rights in Russia.

That is a very complex and difficult question. In Russia 15 years ago the very concept of human rights was regarded as imperialist propaganda aimed at destroying the Soviet Union and communist society. Enormous progress has been made in securing a few basic human rights such as the right to free speech, to information, to travel, to choose one's own job, to create one's own business, and other rights that were absolutely unknown in Russia under communism. But there is still much to be done to strengthen human rights.

One very important issue is the problem in our justice system whereby far too many people end up in prison. Around 300,000 people are in prison merely under orders from the prosecution during an investigation, prior to their case coming before the court. The vast majority of them simply should not be there. Consequently my political party is fighting a serious battle in parliament to liberalise the criminal justice system with the aim of cutting down the number who face imprisonment, especially before their case comes before a court. The media were suddenly very interested when a well-known media magnate spent three days in prison before facing the court. But somehow it is very difficult to bring to their attention the fact that 300,000 other people are in the same circumstances. Thus there is a long and serious agenda associated with human rights.



Throughout its history Russia has spent a large amount of time at war, either internally or with external powers. With Russia now growing into a major economic force, what will stop it becoming an authoritarian regime again? Have you seen any changes that will safeguard Europe and Russians themselves?

One sees a clear connection between the level of a country's economic and social development and its likely political regime. There is not a 100 percent correspondence, but it is close nonetheless. Authoritarian regimes are typically found in countries where GDP per capita and the general level of development is low. Thus rapid economic growth in Russia is unlikely to pose any serious danger of a return to autocratic government. Economic stagnation does bring a risk. If Russia cannot create the pre-conditions for sustainable growth, one cannot exclude the possibility that it will in time evolve back into an authoritarian state. But if and when Russia becomes a dynamically expanding economy, integrated with the world economy and world society, I see no serious danger of a reversion to non-democratic government.

Looking 10 years into the future, how do you believe Russia will be placed as a country?

Things could go very well in Russia, if the present reform agenda is implemented and all the policies for which the reformers have been fighting are adopted. I could also be less optimistic. But I will give you a reasonably optimistic scenario – not one where there are no problems, but a path along which Russia could travel if some of the most urgent problems are resolved.

In 10 years from now Russia will be a democracy and a market economy. Russian per capita GDP will still be very low. In the best possible scenario it will be lower than the GDP of Portugal and substantially lower than that of New Zealand – one half at best. I hope Russia will have genuinely dynamic economic growth by that time. I believe it will be able to maintain and perhaps develop its very good



education system, where it has a comparative advantage. That will allow Russia to participate globally in a knowledge economy and to exploit some of the potential of information technology. Russia will have a modest tax burden, a sensible tax system, a relatively open economy and low tariffs.

Property rights will be better protected than currently. But there will still be serious problems in this area owing to the lack of long-term traditions. Russia will still have difficulties with its banking system, since that system is young. It does not have a good history, and cannot change in a short period of time. The Russian bureaucracy will have improved, but will still be far from the most efficient and incorrupt in the world. Thus I would still recommend only very modest government involvement in the economy, otherwise there will be additional corruption. In sum, Russia could be a young market economy, neither very rich nor very poor, but developing dynamically.