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## AN ECONOMIST LOOKS AT POST-SOCIALIST RUSSIA

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**A School for Western Economics / An Impression of Anarchy / Shopping in Moscow / Understanding the Old Soviet System / No Checks, No Credit Cards / A World Without Contracts / The Mafia Takes One-Third / Bring Only New Dollars / The Perils of Privatization / An Advisor from Harvard / Pessimistic About Russia's Economic Future**

### **A School for Western Economics**

I was in Russia for seven weeks last winter teaching economics at the New Economic School, an enterprise run by a member of the Hebrew University Department of Economics in conjunction with a number of Russian scientists. It is located at the Institute of Mathematics and Economics of the Russian Academy of Sciences and financed by George Soros. The school offers a two-year program for Russians who already have a degree, usually in mathematics, physics, or computers. They are attempting to fit the entire program of economics at both the undergraduate and masters' levels into these two years and they study nothing but economics and English. The program, now in its second year, is conducted in English and the faculty comes from Israel, the United States, Britain, and Sweden. The school's purpose is to educate new academic leadership cadres to teach Western economics in Russia, and thirteen members of its first graduating class have been accepted by American and English universities for Ph.D. programs.

Among about 100 students that I taught was one Jew. One could sense that the country has lost a lot of its Jews. We met Jews who said that they were the last ones left from large, extended families.

I had the opportunity to experience the country not as a tourist, but as one who lived in a Communist-era apartment block, rode the Metro subway, and walked the streets often where I could observe the daily relations between people. Being an inquisitive economist gave me a unique perspective in terms of understanding what is going on in Russia today and I was able to draw certain initial conclusions about the prospects for success of the new free market economic revolution in Russia.

### **An Impression of Anarchy**

The first thing one notices when on the street and not part of a tourist group is the anarchy — there is practically no government in Russia. To cite but one example, one day when we attempted to visit the Kremlin and Red Square, we were not

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aware that it was the anniversary of Lenin's death. The guards at the entrance told us we would not be allowed in and ignored our pleas. Then as we were standing there, a procession of Communists arrived for a demonstration to honor Lenin. One of my students who had accompanied us asked the guards if we would be allowed in if we joined the demonstration. He agreed and in we went.

On another day I returned to the square to take pictures. While walking with my camera open and hanging around my neck, the guards motioned that I should put the camera in its case. I did, went in, walked 50 yards and took the camera out again. None of the policemen inside said anything.

The trollies, both in Moscow and in St. Petersburg, provide yet another example of anarchy. Nobody pays, and nobody cares.

The roads are full of potholes. Half of the equipment of the municipality is disabled and there is no money to buy spare parts. The municipalities also have no money to remove snow and ice from the streets.

The Metro subway is perhaps the best in the world, but it is obviously crumbling. The equipment is getting old and is not being adequately maintained. Yet it is still true that the trains run every few minutes.

The Russians I spoke with explained that there are only three things that can bring the people out into the streets in revolt. One is if they do not have heat or hot water in their homes. I was there in the dead of winter, from January to March, experiencing temperatures of about -35C. The second is if they do not have food, and the third is if the Metro does not run on time. Nothing else will bring the people out of their apathy.

So there was plenty of heat in the apartment, I never ran out of hot water, but the staircase is crumbling. The house is in poor repair on the outside and obviously no one is doing anything about it. Garbage is not collected but rather burned in an open space behind the building at night.

Another salient feature of the anarchy in Russia is the postal system which is virtually non-existent. One cannot send a letter from Russia. For a while, people kept sending letters until a heap of mail was found near the Moscow Airport. The mail bags had been emptied, anything of value had been taken, and the rest dumped. The only way to get anything sent into or out of Russia is via special couriers, who are doing a booming business. When I left, my students gave me letters to mail from Israel to relatives around the world because there is no way they can mail them from Russia.

### Shopping in Moscow

One can buy everything in Moscow, there is no shortage of anything, yet there is no milk left in the government stores after 10 in the morning. Milk is available, of course, because the people who bought all the milk in the government store that morning are now out in front of the store selling it on the street. There is not a big mark-up on the price because there is not a real shortage. The same situation holds true for bread.

There are only two kinds of restaurants in Moscow and St. Petersburg, those you cannot eat in because the food is so bad and those you cannot pay in because one cannot get a decent meal for less than \$60 per person.

At the Bolshoi Ballet the tickets cost between 2,000 and 5,000 rubles each. At the time, 5,000 rubles was about \$3.50. But of course there are no tickets available at the box office at that price because they were all bought up months ago by an organized scalpers' cartel. The scalpers sell their tickets outside of the Bolshoi at the going market rate in a perfect example of a free market. Prices change by the minute according to supply and demand and the tickets are sold for dollars, not rubles. One can tell by the prices how popular a show is. Since there is a cartel controlling the operation, ticketsellers who do not belong to the cartel must beware, and must operate away from the Bolshoi. These independent agents approach people coming out of the Metro and sell the tickets appreciably cheaper and for rubles.

Russia is now filled with kiosks. They take shipping containers, make windows in them, and place them near public places like the Metro. The kiosks are stuffed with imported goods; I even saw vodka from Israel. The proprietors usually live in the kiosks because they are afraid of being robbed. Some of the kiosks are open 24 hours a day. But I did not see any real entrepreneurship in the sense of productive enterprises, like shipping or trucking companies. Coca Cola is shipped in its own trucks. The McDonalds in Moscow is cheap and it works. The difference in attitude toward the customer by Russians employed in McDonalds is striking as compared with the attitude of comparable workers in other Russian stores.

Russia is a country of 150 million people stretching over ten time zones. As nice as these kiosks may be, that is not enough to create the sort of atmosphere and environment in which true entrepreneurship can thrive. It is the equivalent of street hawkers and one can find street hawkers everywhere.

### Understanding the Old Soviet System

To understand what is going on in Russia now, we must look at how the Soviet economy used to be. First, prices never played a role in the Soviet system. It was a command economy. People produced what the Central Planning Agency told them to produce and supplied their products to whomever they were told to supply them. The buyers got their products from wherever the Agency told them to go. As a consequence, there was no room for any interplay between supply and demand, and therefore prices had essentially no role.

Second, there were no banks in the Soviet economy. There were two kinds of transactions: for cash or for notional money. Essentially, salaries were paid in cash and consumers used cash to buy what they wanted. All other transactions were conducted in a bookkeeping manner, that is to say, as if there were a bank and as if a company buying something from another company gave it a check and as if that other company made a deposit in its account at the bank, except there were no checks and no banks. It was simply noted in the books. The only connection between these two systems was that when a company was short of cash to pay salaries to its workers, it could convert some of its notional money to cash. The amount converted was restricted to just that amount that the company needed to pay its workers. They got the cash from the Central Bank, which was no different from the government.

Third, all profits under the old economic system belonged to the government. Any company that had a surplus of cash or notional money would turn its profits over to the government which would then allocate these surpluses to other companies according to the national investment plan. So, for example, a company would be told that it had been allocated 10 million rubles in notional money to buy capital equipment from XYZ company in Ural or wherever.

These three main features of the Soviet economy all have a bearing on the fundamental difficulties facing the Russian economy today. There are still no banks in Russia. What they call banks are nothing but operations that speculate in foreign exchange. Because they did turn the ruble into a convertible currency, one can buy and sell foreign exchange freely in Russia. There is no need to even go to a bank since there is a moneychanger every few blocks who buys and sells dollars.

### No Checks, No Credit Cards

It was a very eerie feeling talking to students of economics who had never seen a check in their lives.

I came to realize how important it is to grow up with such things. When I explain to Israeli or American students about what checks are, they will usually respond, "Now I understand what I have been doing." But because the Russians have never seen a check it is very difficult for them to imagine the whole business. They do not understand what a share of stock is or a bond. As a consequence, I found myself explaining to them about how banks operate and what checks are instead of teaching what I had planned to teach. They were fascinated. These were all college graduates, but they do not know what credit cards are. The Soviet economy totally lacked a modern financial system and they are still stuck somewhere in the Middle Ages.

The fact of a command economy expresses itself today in the lack of a wholesale distribution system. Under the old system the truck from the factory in some God-forsaken place in the hinterland of Russia used to deliver the products straight to the store in Moscow on orders from the Central Planning Agency. It is unimaginable that a modern economic system could function without a wholesale system and the consequence is that for the most part one cannot find in Russian stores those goods that one looks for on an everyday basis. As a result, they import virtually everything. I used to do my shopping in three foreign-owned supermarkets — Irish, Italian and Finnish — in which everything was imported down to fresh milk — the kind in cartons that one finds on the shelves of American supermarkets. It was brought in every day from Finland to Moscow. Apparently these places are supported by the new Russian rich who can afford to pay the prices, which are out of this world. A shopping trip that would cost about \$15 in the U.S. would cost \$60 in these stores. As a foreigner I was able to use a credit card, and appreciated the fact that it took three months for the charges to be billed to my account.

Russia does manufacture a lot, but the consumer goods are either old or shabby or both. The typical Russian car is the kind that was driven in Israel thirty years ago. The Lada, actually a Fiat 124, is the most common car on the road. Those who can afford a luxury car buy Mercedes, BMW or Volvo, of which one sees a lot in Moscow's streets.

### A World Without Contracts

Yet another problem involves the legal system. In the Soviet Union there was never any reason for two private parties to enter into a contract. Everybody was told by the government what to do. Can you imagine a world without contracts? As a result, there is no legal

system to govern contracts — no contract law, nor any contract enforcement mechanism. Although some new laws have been passed, the legal system that would enforce contracts is still essentially non-existent. Russian judges have no experience with such law and there is no system by which to bring lawsuits.

### **The Mafia Takes One-Third**

The anarchy and lack of enforcement mechanisms in Russian society have helped stimulate the growth of the mafia, which to a very large extent operates an enforcement system as a substitute for an official enforcement system. A person opening a business in Russia wants to be sure that a week after he opens he is not hit with some claim by the government that the land he is on does not belong to him. This is a common occurrence because there is no orderly system of ownership of any sort. So he needs somebody to protect him. The mafia does this first by bribery, they buy off whomever needs to be bought off. They occasionally use force because everyone else knows that there is no enforcement system. They know the ropes because they are locals and foreign businessmen may find their assistance useful to act as go-betweens.

The impact of the mafia's presence on the economic system is tremendous. A room in a foreign-owned hotel in St. Petersburg costs something like \$325 a night. About a third of that goes to the mafia. This also partly explains why the prices in the supermarkets are so high.

The state in any reasonably organized country supplies and finances its services with taxes. In Russia, however, taxes are barely collected, another symptom of the absence of government. For example, nominally there are very high tariffs on some products. In practice, however, only a fraction of the tax is paid because the importers bribe the customs officials by splitting the difference. As a consequence, the government take is much lower than what the rates imply. In other cases, companies show no profits by either establishing kindergartens for the workers' families or building a clinic for the workers — doing many things with their money that will enable them to show zero profit and therefore pay no taxes. Russian law is not sophisticated enough to deal with these types of things and even if it were, it is doubtful if anybody could enforce it under the present circumstances.

### **Bring Only New Dollars**

Before I arrived, I received an instruction sheet from the school administration which suggested, among

other things, that I bring with me about \$750 in cash, in bills that were issued in 1991 or later. I could not figure out why but I did as suggested. After my arrival, I exchanged those dollars for rubles because most things can be purchased only with cash. There is no way to transfer money from abroad except for a very steep charge, so we had to live on cash.

One does not dare take a taxi in Moscow because there have been many cases when people who did later found themselves naked in some ditch by the road because the driver took everything they had. But a person does need to get around, the Metro does not reach everywhere, so the school organized its own taxi service, operated by a biology professor, a computer software company owner, etc., who were moonlighting. This is the way they supplement their income. When I needed to go somewhere I approached the biology professor and would pay him in dollars at \$5 per hour. One day I handed him a five-dollar bill and he asked for a better looking bill. He explained that if it was not new enough he might only get 70 cents on the dollar. There is a company in Moscow that buys such bills, ships them to the United States, replaces them with newer U.S. bills, and brings them back. Since people use dollars because of inflation, the stock of bills needs to be replaced regularly. This is an extremely lucrative business and is one way to get rich in Russia. The school administrator was wise in advising us to bring in new-looking bills; otherwise we might not have been able to use them in payment.

### **The Perils of Privatization**

One of the gravest problems with the Russian economy today has to do with privatization. The privatization process in Russia is a scam because the Russians could not bring themselves to literally sell off a state corporation to the highest bidder. What they did instead, essentially, was to rig the system to make it possible for the workers and managers to purchase these enterprises themselves. Consequently, the vast majority of enterprises that have been privatized are largely owned by their own workers and managers, who simply rob the business blind. They sell natural resources and minerals abroad and simply pocket the money. They are underselling the world market and getting rich in the process. They buy off the customs authorities who would otherwise prevent such practices. This is not such an expensive proposition because the salary of a government worker in Russia these days is only about \$50 a month. This is not enough to live on so most people moonlight.

People are also able to survive because there are so many services they get that are essentially free. Housing, electricity, hot water, and heat are virtually free. The librarian at the New Economic School told me that she pays a thousand rubles a month for electricity, hot water, heat, and apartment building upkeep combined, which comes out to about 60 cents. A ride on the Metro is about 3 cents.

Under these circumstances, companies cannot pay their bills to other companies from which they buy raw materials. They give out IOUs as if the old Soviet system of notional money still existed. Inevitably there comes the day when they do not have enough cash to pay salaries. At that point the Russian government has a choice, it can either let the company crumble and precipitate very substantial unemployment or it can print money and give it to the company in the form of a credit which it will never repay, in order to enable it to pay its workers. So far, the government has opted for the second route. They keep printing money to enable companies to pay salaries, but they have no way to cover these sums. The money does not come out of taxes but simply from running the printing presses. This is essentially what fuels the inflationary process in Russia.

#### **An Advisor from Harvard**

Jeffrey Sachs is a professor of economics at Harvard who advised the Russian government. Under his guidance the government began a free market revolution on January 1, 1992, when prices in Russia were freed from state control and when the supposed new era began. Sachs believes that the Western economic powers are behaving very badly toward Russia by not providing it with very substantial foreign assistance. He says the Western countries should have given Russia some \$50-70 billion in order to facilitate the move toward free markets.

Having been in Russia, my conclusion is that Sachs is totally wrong. It does matter in which order one goes about the revolution in which a Soviet-type economy is transformed into a free economy. The right order is not by first freeing prices. Free prices in markets that do not exist do not mean anything. Without a wholesale distribution system or a financial system, free prices are meaningless. In my opinion, this step has probably caused a huge amount of damage in Russia.

The situation in Ukraine is ten times worse, which is one of Sachs' favorite arguments. He points to the fact that Ukraine is so much worse off and uses that

to justify the moves that Russia undertook according to his advice. The truth is that Russia has much greater natural resources than Ukraine. In particular, Russia is a big exporter of energy and Ukraine is a major importer.

#### **Pessimistic About Russia's Economic Future**

The Soviet economy is not strictly comparable to any other of the Eastern European economies. The Communists systematically destroyed Russia's economy for seventy years, whereas they managed to destroy the economies of the other Eastern European countries for only forty-five years or fifty years in the Baltic states. So Russia is in far more dire straits than are Poland or Hungary. From what I saw there, I would not give the Russian economy more than a 20 percent chance of success. I am not very optimistic about what is going to happen there, which is why the Jews who still remain there should leave in a hurry.

The likely scenario a few years from now is a backlash against the failures of their so-called free market economy. The Russians are being told that what they have now is a free market. The consequences they see are likely to be attributed to the failings of that type of economy, and they may well choose to vote in the future for someone who will want to turn back the clock in an attempt to end the dislocations caused by these ill-advised and poorly planned moves toward a truly free Western market economy.

Russia was still practically a feudal system before the Communists took over. There may not be a single Russian who has any notion of what entrepreneurship means. One has to grow up in a certain culture in order to be an entrepreneur. The hard reality is that in Russia today such a culture that would be receptive to the practical absorption and adoption of true free market economic practices and methods of operation simply does not exist.

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**Political and Structural Arrangements in the New Era  
of Israeli-Palestinian Relations**

*Conference Proceedings, December 1993*

After the Oslo Agreement between Israel and the PLO, the Jerusalem Center for Public Affairs and the Konrad Adenauer Foundation sponsored a conference on Political and Structural Arrangements in the New Era of Israeli-Palestinian Relations, which was held in Jerusalem on December 6-8, 1993. Some 21 speakers explored possible structures and relationships between Israel and the autonomy, the political implications of the new arrangements, related experiences of other countries, the politics and election of the Palestinian council, avenues for functional cooperation, and legal and constitutional issues including settlements and jurisdiction. Included among the speakers were four representatives of the Palestinian community — a leading Gaza notable, a professor of political science from Bethlehem, a well-known Jerusalem writer, and a member of the PLO delegation to the peace talks.

Jerusalem Center for Public Affairs and Konrad Adenauer Foundation, 1994, 218pp.  
Softcover \$15.00

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**Understanding the Jewish Agency: A Handbook, Third Edition**

*Daniel J. Elazar and Andrea S. Arbel*

The most important institutional task facing the Jewish people today is creating a proper structure and process of governance for the emergent world Jewish polity. As the major institutional link between the State of Israel and the diaspora communities, the reconstituted Jewish Agency stands at the nexus of this effort. Originally published as the first book-length guide to the Jewish Agency in 1984, the fully-updated Third Edition of *Understanding the Jewish Agency* gives a comprehensive overview of this important political instrumentality's history, evolution, present-day structure, activities, and relationship with world Jewry, complete with detailed charts and tables.

Jerusalem Center for Public Affairs, December 1993, 187pp.  
Softcover \$21.00

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**The Political Economy of Israel: From Ideology to Stagnation**

*Yakir Plessner*

The failure of the Israeli economy can be explained by its departure from the institutions and rules which govern predominantly market economies. Israel's economy has been operating on principles too far from European Liberalism (or American neo-Conservatism) and too close to Socialism. While national imperatives may have been a reason for ignoring economic considerations, ultimately this strategy led to domination of the economy by the government and the systematic exclusion and distrust of private enterprise. As long as the economy is not reformed to create a hospitable climate for private investment, Israel will not be able to extricate itself from economic stagnation. A major critique of Israel's socialist economy, this work is part of the JCPA's study of the political economy of Israel.

State University of New York Press, 1994, 330pp.  
Softcover \$21.95; Hardcover \$65.50.