

# *Collapse of an Empire*

by Yegor Gaidar, Brookings Institute Press, 2008, 382 pp.

## Dick Wilson

**Also under review:** *State and Evolution: Russia's Search for a Free Market*, Yegor Gaidar & Jane Ann Miller (Translator), University of Washington Press, 2003 (first published in Russian in 1994), pp. 176; *Days of Defeat and Victory*, Yegor Gaidar & Jane Ann Miller (Translator), University of Washington Press, 2000, pp. 342. [1]

### The temptation to action

...like it or not, politics are less a choice between good and evil than between greater or lesser evils. (Yegor Gaidar)

The three books under review vary in content, but are all written to a single purpose. Their task is to explain and defend the actions of a small group of reformers during the upheaval that marked the demise of the Soviet empire. The author, Yegor Gaidar, was one of the principal actors in that drama.

I met Gaidar in the early 1990s, when he was deputy prime minister of the Russian Federation. At my request, he agreed to a meeting so I could inform him as to the depth of anger among the miners over the wage arrears issue, which was driving the miners into poverty. I knew he was aware of the problem. But I wished to give him chapter and verse and a sense of the considerable disaffection with Yeltsin because of this issue. We met at about 11 in the evening at the Kremlin. I was ushered into an 'office' which looked nearly as long as a football field. [2] At first I could not make out the person sitting at the desk at the opposite end, but Gaidar quickly left his work and came up to greet me. It had all the atmosphere of a novel. He was an impressive person, an intellectual turned temporary politician. He flew out the next day to meet with the miners in western Siberia.

Gaidar is probably the best-known economist in Russia, and possibly the least understood. Both appreciations date back nearly eighteen years, when he agreed in October 1991 to become adviser to President Boris Yeltsin. His advice was sought as to how the Russian economy could be repaired. A response was urgently needed because Yeltsin had taken steps to separate Russia from the Soviet Union, effectively ending that empire nearly seventy years after its birth. It was an unceremonious

burial of what Lenin had wrought and Stalin had once ruled. Only the paperwork was left to note its passing.

This extraordinary change had as its immediate cause the events of August 21-22, 1991, when hard-line Communist Party leaders attempted a coup against Mikhail Gorbachev, President of the Soviet Union. Arresting Gorbachev while he was on vacation, the plotters called out army units with orders to take over the Supreme Soviet. Tanks surrounded the 'white house,' headquarters of the Supreme Soviet. The only thing standing in their way was Boris Yeltsin and an outpouring of citizens opposing the coup. From atop Tank No.110, Yeltsin condemned the attempted take-over. He ordered the tanks and troops off the streets of Moscow and back to their barracks. They did as he said. The coup failed, its plotters were arrested. Yeltsin then shut down the Party, confiscated its assets, and declared the Soviet Union finished. Later, Yeltsin along with the Presidents of Ukraine and Belarus declared the Soviet Union 'no longer a geopolitical reality.' The other Republics signed on soon after. Gorbachev at first opposed the break-up of the USSR but came to accept this new reality: he officially resigned his post as President at the end of that month and publicly accepted the fact that the Soviet Union no longer existed. (C 226)

Yeltsin and Gaidar were both convinced that something drastic was needed to restore the economic health of this new Russia. People struggled day after day, trying to find the necessities of life. They stood in lines for hours, and the lines kept growing. Yeltsin turned to Gaidar for advice.

The planned economy, Gaidar argued, was a farce. It failed because the economy was much too complex for bureaucrats in Moscow to make all the decisions. Questions of efficiency, productivity, and technical progress were smothered to maintain domination by the state. There was no possibility of returning to the days of fear and brutal administration to fulfil planned output.

The immediate need, however, was to eliminate the shortages, the empty shelves in the stores, and the long lines waiting for what little was available. That could only be done by the elimination of price controls. Gaidar proposed a radical reform, one which would start Russia on the road to a market economy. It would be harsh at first but he believed it would set the stage for stability, which could then be a platform for growth. Otherwise, Gaidar predicted longer and longer lines, further economic contraction, and runaway inflation. Yeltsin both 'grasped the breathtaking risk

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connected with beginning the reform' and understood that 'passivity or dallying would be suicidal.'

Yegor Gaidar's vision was a market economy where private rather than state enterprises would be the backbone. It would require a massive effort at privatisation. But privatisation would not work without eliminating the existing control of prices by the state. Prices had to reflect the availability of goods and services. Only when prices are set by the market can the real costs and the real opportunities for return on new investment be judged. Yeltsin not only bought the program, in a broadcast on October 28, 1991, he announced that 'We need now a reformist breakthrough... We shall begin in deeds, not just words.' (D 90)

In early November 1991, Gaidar was officially made advisor to the new independent government. But in a matter of only hours, he was no longer just an advisor but was named Vice Premier and Finance Minister. His modest assignment was to fix the economy of the newly independent Russian Federation, which was in shambles.

It was Gaidar's initial understanding that Grigory Yavlinsky was to join the government and it would be Yavlinsky's job to implement the reform, not Gaidar's, who was to be strictly an advisor. '[I]t felt as if I'd just managed to jump out of the way of a speeding train.' Then came the news – 'my information was incorrect, Yavlinsky had refused.' (D 91)

Would the outcome have been any different had Yavlinsky enlisted? Possibly. Yavlinsky was author of several variations of 'The 500 Day Plan' advocating a market economy. This program differed from Gaidar's in that it insisted on a slower, more calibrated effort, starting with privatisation and only later a very gradual release of price controls. Though Yavlinsky had found support initially in the legislature of the Soviet period, and in the West, there were no powerful voices on his side.

The economic reforms were also undertaken without a constitution or clear lines of authority over banks, institutions of various kinds, or state agencies created by the Soviets. All of the powers – and checks and balances – needed to run a government were missing. Everything hinged on the popularity and personality of Boris Yeltsin, who had no political party behind him, a legislature made up of delegates originally picked by the Party and who were now emboldened by being free of all obligations to constituents, Party, or political leaders. Russia was more a name than a country at that point. Even the borders of the new nation were unclear and unguarded.

The response to these extraordinary events needed to be something beyond what is implied in the word 'reform.' It required an answer to what had become a revolution.

For Gaidar, it would have been impossible to just stand by as the country slid further and further into chaos with a real threat of violence hanging over it. One had to take the risk of action, where much would be the product of guesswork and the outcomes unclear. One had to be willing to ignore criticism. So Gaidar stood up, willing to act despite the barrage of criticism brought down on his head. He was that rare intellectual who refuses to breathe in the easy air of the sidelines and who is willing to sacrifice his intellectual virginity to do, if necessary, nothing more than win the lesser evil.

When Yavlinsky said 'no' and Gaidar said 'yes' to a key post in the government, a small crack was made in the already fragile foundation of Russian democracy. That crack would grow as the reform unfolded. At a later point, it would become a significant factor in splitting democratic forces in Russia. (By the 1993 elections, the party Democratic Choice founded by Gaidar, and Yabloko organized by Yavlinsky, were in competition – a division that continues, regardless of party name, to this day.)

As Yeltsin and Gaidar ventured forward in the late autumn of 1991 to begin their remedies for revolution, they were faced with the reality described by Gorbachev a year earlier: 'Our economy and entire social organism are exhausted by chronic diseases. The dilapidation of the village, agriculture, and manufacturing, the woeful state of our ecology; the obsolete structure of production and lagging behind in science and technology.' (C 132)

What all this added up to, in Gaidar's words, was a 'revolution comparable in its effects on the historical process with the Great Revolution in France, the Russian Revolution of 1917, and the Chinese Revolution of 1949.' (D xxii)

#### **At work**

Gaidar was barely on the job when he was faced with a crisis of the kind he had not expected – a dire shortage of food and the threat of famine. The reserves of grain were nearly depleted. Without grain, bakeries would close; citizens, who depend on bread as their staple food, would be left hungry. This was a formula for riot.

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Russia could not feed itself and grain had to be purchased in increasing quantities from other countries. Rubles could not be used, so grain from abroad had to be paid for in hard currencies. The supply of hard currencies depended on oil sales, but starting in the mid-1980s and continuing through the 90s there was a sharp fall in oil prices.

Russia turned to loans from foreign banks to pay for the imported grain. By the time Gaidar became Finance Minister, that door was closing. Unpaid loans would soon mean a loss of credit not only for grain but other imported goods as well, such as machinery for oil and gas extraction. Unable to make these investments, productivity started falling in key export industries such as oil.

The oil crisis highlights the essential fault in the Russian economy. The real Russia that had for many years been hidden from public view was deficient in manufacture and stuck with an aging capital stock. It was primarily a supplier of natural resources such as oil, gas and metals. Most of their manufactured products largely failed to sell on the world market because of their poor quality and lagging technology.

Low productivity is a general problem for Russia. The command economy at the peak of its 'success' induced greater output only by threats of violence, jail, induced famine, or transport to the Gulag. Fear was the motivator. Starting on May 5, 1953, with the death of Stalin, the grasp of fear – slowly, almost imperceptibly at first – started to relax. The command economy began to command less successfully, and as it did productivity slowed. In other words, Russia was much more like an overgrown Angola or Venezuela, rather than a Germany or Japan or United States. But what she really had was natural resources in great abundance. The value of these resources was dependent on highly volatile prices in the world market, a situation that continues to this day, as Vladimir Putin attested late last year, when he noted that 'We have still not yet succeeded in breaking away from the inertia of development. Based on energy resources and commodities... we're still only making fragmentary attempts to modernise our economy. This inevitably only increases our dependence on imports of goods and technology and reinforces our role as commodities base for the world economy.' (Putin 2008)

Oil is Russia's largest and most important natural resource but there's a long list of others, including reserves of nickel, copper and cobalt, and iron. The demand for these commodities is tied to the growth and stability of the world economy and

subject to volatile price changes, big swings up and down and back again, following the same path as oil prices.

The importance of commodities to Russia is made clear by the simple fact that they comprise 70 percent of her exports and provide 30 percent of the national budget. Dependence on commodities has too often bred the speculator whose eyes are on the quick investment and fast turnaround, seeking to sell a product made by somebody else, in some other place. As Vladimir Putin made clear last year, Russia desperately needs to modernise. To do so – that is, to go beyond the market for commodities, requires the creation of new and growing entrepreneurial class: business men, who are willing to make long term investments.

### **Reform midst revolution**

The dilemma of price controls is not a new one. In France in 1774 a Deputy remarked from the floor of the French Convention that 'if we destroy the price ceiling, then the price of everything will rise sharply; but if we keep it, there will be nothing to buy.' So, on January 2, 1992, price controls were lifted on most goods, and a few weeks later, on nearly all of the others. The shelves were, after a short delay, well-stocked once again. The lines disappeared. It was exhilarating at first. People started to use their savings. Inflation accelerated, climbing higher each month.

Prior to lifting price controls, savings had grown rapidly due to higher wages, but nothing much to buy. The money was a measure of what Gaidar called 'repressed inflation.' And sure enough, when price controls ended, the money burst out of the bank accounts and went shopping.

Eventually, savings were drawn way down or entirely used up. As that started to happen, inflation continued but at a slower pace. Over all inflation shot up by 2500 percent that first year, but as savings got spent, inflation dropped to 204 percent in 1994 – still not much to brag about.

Gaidar felt there would be 'reserves of optimism' left to move through the reform and then to an upturn that would change the very structure of the economy. The alternative he felt, would be a suicidal revolt. (S 104) No revolt occurred, but frustration grew as inflation continued with no sign of stabilisation yet on the horizon.

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There was, however, in all this difficulty, one very significant change. Once the prices were free and shelves filled up again, there was little chance going back to controls mandated by a central, planned economy. It was undone and difficult to revive.

The second part of the reform was attempts to control the legislative spending, cut military outlays, and end the automatic response by the Central Bank to cover the deficits. The one success was reduced military expenditure. But the legislature and the Bank would continue to fuel inflation.

Gaidar had not been unaware of possible stumbling blocks to a successful reform. There were many reasons to move fast but certainly his temptation to destroy the command economy once and for all was high on his list. He believed his reform package was the only option open. Certainly, had things continued as before in another six months there would have been nothing to get in line for. (During the French Revolution, when the Convention did not lift the controls on prices, famine ensued.)

And the payments crisis continued as reserves of hard currency and gold disappeared. Russia's dependence continues to this day as imports account for 70 percent of the food for her large cities

The push for reform in the 1990s is, even today, a subject of great contention and divides the democratic parties in Russia. Gaidar's pragmatism and willingness to settle for less than the optimum is not acceptable to Yavlinsky and friends.

### Privatisation

The necessary complement to setting prices free is private ownership of the means of production. Together, they are a formula for a market economy, a platform for growth and future prosperity, and together they defeat, once and for all, the command economy and its overweening bureaucracy, and insure against its resurrection.

Anatoly Chubais, a member of the team of young economists assembled by Yegor Gaidar, was quickly recognised for his political and administrative skills. He became Vice Premier tasked with prying away the hold of the state on the economy by putting as many state-owned enterprises as possible in the hands of entrepreneurs –

Marxism in reverse. Working from the State Committee on Property, an agency he created, Chubais went to work on privatising state owned enterprises. With fits and starts, he managed, by the end of 1994, to establish 100,000 new companies out of the old. By the end of 1996, 72 percent of the midsize and large state enterprises and 80 percent of the small shops and retail stores were put in private hands. Together these privatised businesses, would account for about 70 percent of the GDP by the end of 1997. [3]

Two serious problems emerged in the privatisation phase. The first had to do with the 'red directors' from some of the largest enterprises, who wished to limit ownership of 'their' enterprises to themselves and, to make it palatable, their employees. With various formulas, some of the shares went to the management and others to employees. The actual split varied. Never the less the enterprise would have to operate in a market economy. The allocation of supplies, sales and purchase of intermediate goods was no longer a function of the state.

The second, and most explosive issue, was the privatisation of a number of large enterprises, in the natural resources sector, which included oil, and in some cases metals like nickel. These enterprises were sold at low prices, given their potential, to a small group of wealthy individuals, the so-called oligarchs. This was to be a grievous political wound for the reform, then and for years afterward.

### **Critics and criticism**

'To censure the result of Russian economic reform has become as fashionable as criticising fatty foods or fighting cholesterol,' said Vladimir Mau, capturing both the extent and the extravagance of the criticism levelled at those who laboured for economic reform. A major source of disparaging comment comes from the Kremlin, which likes nothing more than to compare the Putin prosperity with people's plight in the 1990s. Putin, in an address to the Federal Assembly in 2005, recalled 'Individual savings were depreciated and old ideals were destroyed. Mass poverty began to be seen as the norm ... dramatic downturns, unstable finances, the paralysis of the social sphere.'

However, the most important criticism was uttered by Grigory Yavlinsky. Its importance is to be found not so much in its content but the fact he is a leading voice on behalf of democracy. To leave no doubt as to his view of the failures of Yeltsin-Gaidar reform, Yavlinsky argued in *Izvestia* (July 12-13, 1995) that 'the



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crisis of the democratic movement began when its future was staked on a minority.' That minority is identified as the 'business interests' – in other words the old nomenklatura.

Gaidar, who had written a detailed description of the machinations of the ruling class, nevertheless recognized that 'Russia could not be wrested from the nomenklatura by force.' (S 82) There would be no market economy until a significant section of the nomenklatura found it in their self interest to support reform.

Gaidar unabashedly worked to keep the old nomenklatura from misuse of state assets, and to convince them to trade away official positions for private property. He was later to work with entrepreneurs helping to form the Union of Right Forces to improve the environment for expansion of private enterprise.

Yavlinsky's hardest hitting criticism of Gaidar & Co. was on the issue of monopolies, where one, or a few large enterprises in a sector are able to avoid competition and innovation. Support for Yavlinsky's critique comes from George Stiglitz, Nobel winning economist, who cites the example Poland where privatisation was delayed until the ground was ready for the market, and monopolies were divided into several smaller competing companies.

But Russia was not really comparable to Poland. For the chance to have their kind of controlled privatization, Poland won the strike at Gdansk, built the Solidarity movement reaching into nearly every work place, launched a struggle underground during martial law, brought all sides to the round table, gave the government an overwhelming defeat in the election and had the inspiration of a Polish Pope. The distance between Warsaw and Moscow is beyond calculation. There was simply no time in Russia. The differences between the Gaidar and Yavlinsky in part concerned their understanding of this. Gaidar felt he was in a revolution where possibilities were measured by days, weeks, and, if lucky, a month or two.

### **The weak state as harbinger of revolution**

One could draw an analogy with February 1917. Gorbachev was Alexander Kerensky trying to represent all from the middle. He failed and his weak government proved unable to hold together the divergent factions. Arrested by his associates on the Central Committee, who tried to topple his government, Gorbachev returned after the coup failed but only to find the radical democrats and the pro-market

economy faction had swept away the USSR. The times required the will to be willing to act, and not stop, or be pushed aside by different new coalitions arising from the revolutionary situation. This was a time when one might have to settle for the lesser evil – a time to act, regardless of the naysayers. [4]

The 1990s were to be marked as a great failure by the Kremlin and by some democrats. There are few defenders of the reforms and political changes of the decade. But the man who stood on tank No. 110, and the small bunch of reformers who were tempted to act with him, do have a few accomplishments to their name. The shortages and the lines went, and with them, the command economy, as nearly one million privately owned businesses were registered. The rule of the nomenklatura's Communist Party was over, and an environment in which people could speak up was created. Russians could travel abroad without permission and did in large numbers, while three in four now owned a piece of land. Overlooked in the dismal figures, thirty one families out of every hundred owned a car, and grain production increased to the point where 10 million tons was exported in 1997. And, this not least in importance, elections meant something, the candidates were not chosen by the Party, and the dream of democracy was kept alive. [5]

### Postscript

As this article was being written, Yegor Gaidar resigned his membership in the Union of Right Forces (SPS). He had little choice. The decision was forced on him by a meeting of the SPS on October 3, 2008 which the party to join with two other parties to form a new political organisation. The purposes given by the sponsors of this newly merged party are intentionally vague. However, for most everyone else, it is clear that they seek a safe harbour in the Putin consensus. The Kremlin has pre-approved the merger.

The SPS had attempted to follow a pragmatic course of 'political responsibility.' This meant support for proposals such as the flat tax, or other legislation helpful to the businessman, but opposition to the government when it abused its power. Such a middling position was unacceptable to the Kremlin and the SPS found itself without a single seat in the legislature (Duma). It is assumed that the new party will be allocated representation in the Duma. Of course, United Russia, the party of Vladimir Putin, will continue its position of majority control.

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In a terse statement to the press, Gaidar said, 'I believe my participation in this project would not contribute to its success. That is why I have submitted a letter of resignation.' (October 3, RIA Novsti)

Just prior to Gaidar leaving, the Chairman of the SPS, Nikita Belykh, had also resigned. He made it clear that he had 'no intention of doing deals with the Kremlin.' Belykh started working with Gary Kasparov's very anti-Putin group 'Solidarity.' But on December 5, 2008, he was invited to Vladimir Putin's office and offered the opportunity to work for the Kremlin. He accepted the offer. Belykh was appointed Governor of Kirov on December 9th, 2008.

Chalk one up for the cynics. But don't miss the flickers of light shining from the increased street demos. One comes from 'Da!' (Yes!), a new youth group led by Maria Gaidar, a fighter, like her father.

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**Notes**

- [1] Henceforth, for referencing purposes, *Collapse of an Empire* is 'C,' *Days of Defeat and Victory* is 'D' and *State and Evolution* is 'S.'
- [2] Gaidar wrote in *Days of Defeat and Victory* of 'that long, long, narrow, absurd room in the Kremlin.'
- [3] Aron 2006, p. 329.
- [4] See Mau and Starodubrovskaya 2002 for a discussion of revolution and the weak state.
- [5] A longer list of examples can be found in Aron 2007.