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Economic Transition in Russia, the Ukraine and Belarus in Comparative Perspective

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Materials published in this series have a character of working papers which can be a subject of further publications in the future. The views and opinions expressed here reflect Authors' point of view and not necessary those of CASE .

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Introduction ¹

Russia, the Ukraine, and Belarus, three successor states of the former Soviet Union (FSU), started their transition to a democratic regime and market economy from the same initial point of the late stage of Gorbachev's *perestroika*. The Soviet economy was at that time in complete macroeconomic chaos characterized by deep fiscal crisis, enormous market shortages (repressed inflation) and a severe balance of payments crisis. Government authorities both on all-Union and republican levels lost effective control over state-owned enterprise (SOE) behavior due to uncontrolled, spontaneous *de facto* decentralization of corporate governance. This was connected with the beginnings of spontaneous *nomenklatura* "privatization," which mainly consisted of non-legal transfers of profits and assets from the SOE to other persons. Additionally, the all-Union government lost control over the monetary and fiscal policies of the biggest republics, especially the Russian Federation. Interrepublican trade started to decline mainly as a result of huge shortages and the consequent autarchic policies of the republics² as well as the accelerating deterioration of the traditional payment mechanism. Of course, we must also remember the enormous structural distortions accumulated during more than 70 years of existence of the communist system.

Thus, the three analyzed countries had to experience many similar problems and obstacles on their way to a market economy. The scale of initial economic and political difficulties in the FSU was far more substantial than in Central Europe (see Dąbrowski, 1995) or in Eastern Asia communist countries (see Sachs, 1995). This is perhaps one of the reasons why the results of economic and political transition in Russia, the Ukraine, and Belarus have fallen far short of the results achieved by Central European countries. However, the experience of the Baltic countries - especially of Estonia (see, e.g., Bauc, 1995) - shows that even the difficult Soviet heritage can be overcome, yielding more successful reforms than those in the three big Slavic successors of the USSR.

Generally, it would be very hard to state that Russia, the Ukraine, and Belarus have been successful so far in the reform effort. The reasons for this situation will be analyzed in this paper.

In spite of many similar problems experienced during the transition process, the three analyzed countries differ with respect to the direction and size of the external economic shock experienced after collapse of Soviet Union. Theoretically, Russia was able to achieve significant gains from stopping the delivery of energy resources and other raw materials to its neighbors at prices far below world levels and from stopping

¹ Paper prepared for the Russian Littoral Project Conference on: *Economic Transition in the Newly Independent States: Prospects for Sustainable Development and Integration into the Global Economy*, August 15-19, 1995 Odessa, Ukraine

² These autarchic tendencies were noticeable as well in inter-*oblast'* trade within the biggest republics. Large cities such as Moscow, St. Petersburg, and Kiev, which were in a privileged position under the Soviet planning and distribution system became in 1990 and 1991 a subject of the spontaneous trade restrictions from the surrounding agricultural *oblast's*.

explicit and implicit fiscal transfers. On the other hand, the Ukraine and Belarus suffered an enormous worsening of terms of trade with Russia. They also started to have problems with demand for many of their manufactured products oriented earlier mainly towards the Russian market and military purposes. However, the three analyzed countries also differed with respect to adopted transition strategies, including timing and sequencing of reform steps.

At the very end of 1991, Russia began to attempt to implement an ambitious transition package modelled to some extent on Poland's experience. Unfortunately, political obstacles, the conceptual weakness of the initial reform scenario, and the lack of sufficient consistency in its implementation (see Dąbrowski and Rostowski, 1995) led to at least partial failure of this effort. However, Russia has, during the last three years, made substantial progress toward a market economy, especially with respect to ownership transformation.

The Ukraine and Belarus did not want to follow Russia's reform example in 1992 and 1993. Neither privatization nor serious institutional reforms were started at that time in either country. Although in the beginning of 1992 they had to follow to some extent the Russian price liberalization (because of the common currency and trade area), they tried to change as little as possible in this sphere. In 1991-1993 the Ukraine conducted a very populist macroeconomic policy, which brought the country to the verge of hyperinflation by the end of 1993 (Dąbrowski, 1994; Havrylyshyn, Miller, and Perraudin, 1994). However, after the June-July 1994 presidential election, newly-elected President Leonid Kuchma initiated a big political effort to implement a comprehensive package of economic reforms and regain lost time. The final result of this effort is still unclear as of June 1995.

In contrast to the Ukraine, Belarus followed a quite responsible fiscal policy until mid-1993 and tried to maintain traditional communist control and discipline in the economy. This policy collapsed in the second half of 1993, when Russia adjusted energy prices and terminated the flow of so-called technical credits from its central bank. Additionally, the presidential election campaign and the failure of the idea of monetary union with Russia strengthened inflationary pressure. Since the end of 1993 Belarus has balanced on the verge of hyperinflation and has had political problems with implementing a consistent reform package.

The authors of this paper try to analyze the similarities and differences in the starting conditions, adopted policies, and achieved results of the above three countries. The first part of the paper will be devoted to the initial conditions: the economic heritage of the FSU (especially of the *perestroika* years), differences in the economic structures of the discussed countries, and the level of their mutual interdependence. The second part contains a comparative analysis of the liberalization, stabilization, and privatization processes in each country. The third part presents the differences in macroeconomic performance and the progress of the transition. In the final part we try to analyze the political and other reasons for the observed differences.

Part I: Initial Conditions

1. The common heritage: the collapse of the Soviet economy

All the transition countries in the Central and Eastern Europe (CEE) and the FSU inherited from the communist period a series of serious economic problems. Four of the most important reasons are the following:

1. Total or almost total nationalization of the economy left a very limited role for private saving and implied either explicit prohibition of or serious restrictions on private economic activity. Making matters worse, the official systems of education and propaganda in all communist countries tried to convince people of the superiority of state over private ownership.
2. Huge structural distortions existed, resulting from monopolization, economic autarchy, administrative price regulation, and centralized investment decisions. The communist economies were strongly oriented to domestic and regional markets (the latter through the Council for Mutual Economic Assistance - CMEA) and were more or less separated from other markets by currency inconvertibility, price controls, trade restrictions, and the state monopoly in foreign trade.
3. The burden of social spending was very large relative to the level of economic development (see Sachs, 1995). This part of the communist heritage is a relatively new one. The first decades of communist regime were characterized by rather austere policy in this respect. This situation started to change some time after the death of Iosif Stalin, with the growth of social and political unrest (disturbances in the GDR in 1953, Poland in 1956 and 1970, Hungary in 1956, Czechoslovakia in 1968). Less repressive (in comparison with the Stalinist period) mutations of the communist regimes were looking for some form of social support and legitimization.
4. Domestic and external macroeconomic disequilibrium prevailed and was especially strong in the last years of the communist regimes, during which they lost their capacity to control economic and social life. Partly, this was a result of factors described in points 2 and 3. Only Czechoslovakia, Hungary, and the GDR avoided dramatic macroeconomic crises, but even in these countries (and especially in Hungary) the degree of macroeconomic stability was far from Western standards. Domestic disequilibrium manifested itself in the form of a rising budget deficit and monetary expansion, difficulties in controlling wages, and other serious problems, leading to high inflation either in repressed (a "shortage economy," to use János Kornai's terminology) or in open form. The external imbalances usually led to growing foreign debt.

This list shows the differences of CEE and FSU transitions from the transitions of communist countries in East or Southeast Asia such as China, Vietnam or Laos. The latter inherited fewer structural distortions, mainly because they were far less industrialized than the FSU or CEE (see Sachs and Woo, 1994). China maintained private family farms in agriculture (except for a short experiment with communes) whereas the Soviet Union and CEE (with the exceptions of Poland and Yugoslavia) relied mainly on state and collective farms. Asian communist countries offered their populations far less social support than the FSU and CEE (Sachs, 1995). Finally, they succeeded in maintaining relative macroeconomic discipline.

The above list also gives us an understanding of the differences between CEE and FSU countries. The latter (except for the Baltic states, Moldova, and western parts

of Belarus and the Ukraine) had a longer communist record and a longer break with capitalism, which in Tsarist Russia had only been in the initial stage of development. Communist dictatorship was generally more repressive and state dominance over economic and social life more severe. Anti-market and etatistic indoctrination lasted more than 70 years in the Soviet Union, whereas in CEE and the Baltics they lasted only some 45 years. A greater number of decades of communist industrialization policy, a higher degree of economic autarchy (because of the size of the country), a higher level of militarization, and almost unlimited availability of cheap energy and other natural resources: all these factors contributed to greater structural distortion of the FSU economies than of CEE countries.

The USSR never was a leader of macroeconomic stability among the communist countries. However, the last years of *perestroika* brought the situation in this area to a critical point.

For example, the average annual rate of growth of M2 in 1981-5 amounted to 7.5% (IMF et al., 1990, p. 49), which was already excessive taking into consideration the smaller GDP rate of growth and total price control. In the second half of the 1980s, the monetary expansion accelerated further. The M2 annual rate of growth was 8.5% in 1986, 14.7% in 1987, 14.1% in 1988, 14.8% in 1989, and 15.3% in 1990 (IMF et al., 1990, p. 49). The rising fiscal deficit was a main factor in this monetary expansion. According to the same estimates it amounted to 2.4% of GDP in 1985, 6.2% in 1986, 8.4% in 1987, 9.2% in 1988, and 8.5% in 1989 (IMF et al., 1990, p. 10). Moreover, the partial liberalization of the SOE financial system (i.e., allowing SOEs more flexibility in the use of their financial assets) increased money velocity.

The second half of the 1980s was also a period of significant deterioration of external balances. The current account balance in convertible currencies, positive until 1988 (+US\$ 2.3 billion in 1986, +US\$ 6.7 billion in 1987, and +US\$ 1.6 billion in 1988), radically deteriorated in 1989 (-US\$ 3.8 billion) and in 1990 (-US\$ 10.7 billion) (IMF et al., 1990, p. 10). Consequently, the external debt rose from US\$ 28.9 billion in 1985 to US\$ 54.0 billion in 1989. These developments were connected both with the growing level of domestic macroeconomic disequilibrium (budget deficit and monetary expansion) and with the sharply deteriorating terms of trade, especially in the oil market (IMF et al., 1990, p. 50). Declining oil export revenues and profitability also contributed to fiscal difficulties (oil export was previously a significant source of budget revenues).

The level of the above-mentioned repressed inflation further increased due to monetary expansion, decreasing demand for money, and the remaining price controls. Until the beginning of 1991, growth of the official consumer price index was not high. CPI growth in the state-owned retail trade amounted to 2.4% in 1989 and 5.2% in 1990. The retail price increase in the so-called co-operative trade³ was 0.5% in 1989 and 5.2% in 1990. The same indicators for the *kolkhoz* market were 7.4% in 1989 and 34.3% in 1990 (IMF, 1992, table 11).

³ Shops formally owned by trade cooperatives with prices controlled by the state, however far more flexible than typical administered prices and usually without subsidies.

These figures indirectly illustrate the increasing level of repressed inflation and forced savings. Carlo Cottarelli and Mario I. Blejer assessed that "... *at the end of 1990 the amount of wealth accumulated in monetary form by Soviet households as a result of forced savings was around 170-190 billion rubles, close to 20 percent of GDP and around one third of the existing financial assets*" (Cottarelli and Blejer, 1991). It can be added that monetary overhang was equal to two thirds of private consumption.

From April 1, 1991, in connection with the price reform implemented by the Valentin Pavlov government,⁴ inflation started to take on a more open form. Two estimates of CPI growth in the state retail trade in 1991 are, respectively, 89.5% (calculated from the average level of 1991 and the average level of 1990) and 146.1% (December 1991 to December 1990). Respectively, consolidated CPI growth amounted to 90.4% and 152.1%, and growth of the price index of the *kolkhoz* market to 132.1% and 281.2% (IMF, 1992, table 11). Inflation had a mixed character in the second half of 1991, partly in the form of open price increases, partly in the form of rising market shortages.

The rising budget deficit, financed exclusively by credit from the State Bank (*Gosbank*) of the USSR and also by republican central banks was a main cause of the high inflation in 1991. According to IMF estimates the total budget deficit of the Russian Federation in 1991 (including the consequences of assuming responsibility for the entire budget of the former USSR) reached a level of 31% of GDP (IMF, 1992, p. 12). The Ukrainian general government deficit amounted in the same year to 13.7% of GDP (IMF, 1993a, table 23). That year Belarus achieved a surplus of 2% of GDP (also related to general government operations) (IMF, 1993b, table 24).

Rising state subsidies to support administratively controlled prices, the decrease in output, and weak tax discipline can be seen as sources of this huge fiscal deficit. Some republics (mainly the Russian Federation) started in late 1990 and 1991 a populist competition with the all-union government to see who would provide more social protection and propose lower taxes to SOEs.⁵ At the same time a real decomposition of the ruble area started to take place. Gosbank of the USSR lost control over the credit emission of some republican central banks, again mainly over the Central Bank of the Russian Federation (CBRF), created by the Russian parliament at the end of 1990.

⁴ This was, in principle, a typical administrative price reform. However, it included liberalization components, especially in the producer goods sphere. In the following months, effective price control weakened due to the political decomposition of the all-union government.

⁵ The tax war had two aspects. Lower tax rates offered by the parliament and government of the Russian Federation were intended to stimulate SOEs to change their place in the administrative hierarchy, switching from subordination to the Union to subordination to the republic. At the same time Russian authorities began to seize tax revenues from SOEs on their territory and stop transferring them to the all-union budget. Both practices (especially the second one) were soon taken up by other republics (with a certain time lag).

The weakening of financial discipline manifested itself on the micro level through the fast growth of nominal and "real" wages⁶ in the second half of 1991. In the last quarter to 1991 "real" wages in industry were 33% higher than their average level in 1990 (IMF, 1992, p. 11). This also contributed to the significant decrease in the real profits of enterprises.

In the years of *perestroika*, economic growth in the USSR and the Russian Federation was lower than in the preceding decades and gradually decreased. The net material product (NMP) of Russia increased only by 2.4% in 1986, 0.7% in 1987, 4.5% in 1988 and 1.9% in 1989. Beginning in 1990 NMP started to decrease, by 3.6% in 1990 and 11.0% in 1991 (preliminary estimates) (IMF, 1992, table 4). At the same time the index of gross industrial output amounted to +4.5% in 1986, +3.5% in 1987, +3.8% in 1988, +1.4% in 1989, -0.1% in 1990, and -8.0% in 1991 (IMF, 1992, table 5).

The main reasons for the 1990-1991 recession were the crisis of the central planning system, the motivation crisis in SOEs, the disintegration of trade relations between East European countries after the collapse of CMEA, and the gradual weakening of trade links between Soviet republics.

Thus, the economic heritage of the USSR was extremely difficult. All newly independent states (NIS) at the beginning of 1992 faced the necessity of achieving monetary stabilization and price liberalization and starting the process of market oriented institutional and ownership reforms.

2. Structural distortions, mutual interdependence, and initial differences

Economic relations among FSU countries have been characterized by three main issues: (i) chronic deficits of non-Russian republics in trade with Russia, (ii) a poorly functioning payments mechanism and (iii) a lack of stable monetary arrangements (in 1992).

2.1. Balance of payments deficits

The Soviet Union was composed of 15 republics, which were very differentiated with respect to human, physical, and natural resources. Political integration within the USSR required vertical fiscal redistribution between the Union budget and the republican budgets. Russia provided a net resource flow to most USSR republics. Until the dissolution of the Soviet Union in 1991, two channels of financial transfers were used: (i) direct transfers from the budget of Russian Federation and (ii) (what was more important and harder to estimate) implicit trade subsidies. In inter-republican trade, prices for goods were set by the central authorities, independently of the market mechanism. If the prices of tradable goods and services differed from the

⁶ We use the word "real" in quotation marks to indicate its purely formal, statistical sense. In reality, the increase of "real" wages is not comparable with such growth in market economies, as it is accompanied in the Russian case by increasing market shortages.

world level, then importers of overpriced goods subsidized exporting republics, just as the exporters of underpriced goods subsidized importing republics.

Table 1: Average world market to domestic market price ratios (over all republics and weighted by trade volumes of individual republics) in inter-republican trade by major commodity groups in the year 1990

Sector	Ratio	Sector	Ratio
Oil and gas	2.70	Construction materials	0.97
Electric energy	1.50	Light industry	0.33
Coal	0.94	Food industry	0.38
Other energy	0.71	Other industrial branches	0.63
Ferrous metals	1.18	Agricultural products	0.63
Non-ferrous metals	1.66	(unprocessed)	0.45
Chemicals	0.83	Communication, transport	1.11
Machine building	1.11	and services	
Wood and paper products	0.72	Total trade	0.97

Source: Lucjan T. Orłowski, *Indirect Transfers in Trade...* in *Europe-Asia Studies*, Vol. 45, No. 6, 1993, 1001-1024.

A crude assessment⁷ of indirect transfers was made by the Central Statistical Office of the USSR (*Goskomstat*) for 1987-90 intra-Union trade in fifteen sectors (see Orłowski, 1993). The task of this exercise was to show to what extent inter-republican trade could have changed if, instead of domestic prices, "world market" prices had been applied (see table 1). The ratios demonstrate strongly underpriced trade in oil and gas, where the world market price was 2.7 times higher than the domestic price, and overpriced trade in light and food industry (thus, world prices were 33% of domestic prices).

The energy resources sector had a dominant position in these implicit transfers, taking into consideration its weight in total intra-Union trade. In 1990 the oil and gas sector accounted for almost 62% of total transfers through underpriced exports (see table 2).

Summing up, the *Goskomstat* data reveal that negative transfers exceeded positive ones by about 17% (see table 2). Energy-intensive industries were the main beneficiaries of implicit trade subsidies, and Soviet consumers were those who mainly paid for it.

Indirect transfers were unequally distributed among the republics of the USSR. Transfers were made by the republics which exported underpriced oil and natural gas

⁷ This whole approach is highly questionable for differentiated goods, particularly capital and intermediary ones. It is very difficult, or even impossible, to compare Soviet industrial products, such as cars, machines, etc. with those sold on world markets and, therefore, to assess the level of comparable world market prices for Soviet products. This is why the results are more useful for natural resources and, to some extent, for homogeneous primary commodities (agricultural goods, food products, energy).

and received imported underpriced goods. On the other side, transfers were received by republics which imported underpriced oil and natural gas and exported overpriced goods. Republics rich in oil and natural gas deposits were net creditors of other republics importing underpriced resources. These republics were mostly Russia, Turkmenia, and, to some degree, Azerbaijan. In addition, predominantly Russia and to a lesser extent the Ukraine, Uzbekistan, Kirghizia, and Kazakhstan made transfers through importing overpriced non-oil and gas products. Looking at the data in table 3, comparing the share of transfers in GDP of particular republics we can see that only Russia and Turkmenia were net donors.

Table 2: Indirect transfers in inter-republican trade for all FSU republics, by major commodity groups in 1990 (in millions of current rubles)

Sectors	Indirect transfers through			
	Subsidized exports	% of total	Overpriced import	% of total
Oil and gas	22 552	61.5	-	
Electric energy	966	2.6	-	-
Coal	-	-	70	0.2
Other energy	-	-	4	0.0
Ferrous metals	2 462	6.7	-	-
Non-ferrous metals	3 878	10.6	-	-
Chemicals	-	-	3 216	7.5
Machine building	6 333	17.3	-	-
Wood and paper products	-	-	1 432	3.3
Construction materials	-	-	78	0.2
Light industry	-	-	19 203	44.8
Food industry	-	-	13 372	31.2
Other industrial branches	-	-	2 017	4.7
Agricultural products (unprocessed)	-	-	3 489	8.1
Communication, transport	474	1.3	-	-
Sum of transfers	36 665	100.0	42 881	100.0

Source: Lucjan T. Orłowski, *Indirect Transfers in Trade...* in *Europe-Asia Studies*, Vol. 45, No. 6, 1993, 1001-1024.

Summing up the source and direction of indirect transfers, the Soviet republics can be presented in four well-known boxes (Table 4). It shows that Russia was the only republic that made net transfers through underpriced export of oil and natural gas and overpriced import of other goods. Belarus is among eight small and mostly underdeveloped republics which were double recipients (through underpriced import and overpriced export). Finally, the Ukraine belonged to the republics which were subsidized through underpriced import of oil and natural gas and on the other hand acted as donors importing overpriced goods. The Ukraine was the biggest recipient of indirect transfers of energy resources from Russia in that group.

Table 3: Regional structure of indirect transfers in 1990 (in millions of current rubels)

Country	Transfer donor through:		Transfer recipient through:		Net transfer as % of GDP
	Underpriced exports of oil and gas	Overpriced imports of non-oil and gas	Overpriced exports of non-oil and gas	Underpriced imports of oil and gas	
Russia	15 811	13 867	4 071	3 166	3.67
Ukraine	430	3 500	2 780	6 979	-3.61
Belorussia	1 564	1 281	2 745	3 699	-8.91
Uzbekistan	833	2 274	2 113	1 403	-1.26
Kazakhstan	1 672	1 748	1 666	1 984	-0.50
Georgia	5	917	2 877	432	-16.02
Azerbaijan	936	845	2 465	906	-10.09
Lithuania	285	333	1 479	1 480	-17.09
Moldavia	0	577	3 148	-532	-24.05
Latvia	7	397	1 096	559	-10.43
Kirghizja	24	605	516	336	-2.72
Tadzhikistan	22	617	756	339	-6.08
Armenia	0	910	1 439	350	-9.16
Turkmenia	963	583	659	98	10.81
Estonia	0	329	948	287	-12.08

Source: Lucjan T. Orłowski, *Indirect Transfers in Trade...* in Europe-Asia Studies, Vol. 45, No. 6, 1993, 1001-1024.

Table 4: Donors and recipients in interrepublican trade in 1990

		Underpriced trade in oil and gas	
		Donors (Exporters)	Recipients (Importers)
Overpriced trade in non-oil and gas products	Donors (Importers)	Russia	Ukraine Uzbekistan Kazakhstan Kirghizia
	Recipients (Exporters)	Turkmenia Azerbaijan	Belarus Georgia Lithuania Moldova Latvia Tadzhikistan Armenia Estonia

Source: Lucjan T. Orłowski, *Indirect Transfers in Trade...* in Europe-Asia Studies, Vol. 45, No. 6, 1993, 1001-1024.

As a result of price adjustment in inter-republican trade, Russia gains the most due to underpriced exports of oil and natural gas. Belarus has been in the position to face the biggest lost, because of overpriced exports of chemicals, light and machine

industry (high energy consumption). Net exporters of agricultural production, like Ukraine can be negatively effected through opening markets for a foreign competition which has forced to lower prices in the trade among FSU countries.

The changes in relative prices caused a significant adjustment in the energy-importing FSU countries. Import volumes declined in a number of former republics, which was one of the main reasons for large output (and GDP) decline in FSU countries (see section III.3).⁸ However, the terms of trade shock was partially softened by financial transfers extended by Russia (see section II.2.). Most of this financing was provided by the CBRF through its correspondent accounts with other central banks and through technical credits negotiated on a bilateral basis (see table 5). Additionally, Russian enterprises financed enterprises in the other states of the FSU through the buildup of inter-enterprise arrears (equivalent to about 1% of Russia's GDP in 1992) (IMF, 1994).

Table 5: Financing of Other States by the Central Bank of the Russian Federation in 1992

Item Country	End of 1992 CBRF correspondent account position	
	In billions of current rubles	In % of GDP
Russia	-2,109	-11.7
Armenia	34	49.0
Azerbaijan	51	25.8
Belarus	102	10.7
Estonia	4	4.0
Georgia	69	51.5
Kazakhstan	407	25.5
Kyrgyzstan	42	22.9
Latvia	2	1.0
Lithuania	9	3.2
Moldova	27	11.3
Tajikistan	36	90.7
Turkmenistan	172	53.3
Ukraine	862	21.7
Uzbekistan	292	69.9

Source: Russian authorities and IMF data

The financing received from Russia by some countries of the FSU amounted to one third or even more of their GDP (Table 5). Also, some portion of cash emission (about 3% of Russian GDP in 1992) could be considered as financing, since the

⁸ Deliveries of crude oil and oil products by Russia to other states of the FSU dropped by about 43% between 1990 and 1992. The decline resulted from falling oil production in Russia, an increase in the share of exports to countries outside the FSU and lower demand in the states of former USSR due to a deterioration in the terms of trade.

Russian cash rubles were used by enterprises and individuals from the other states to import goods from Russia.

2.2. Payment mechanism

The payments system in the USSR was not based on market discipline, as it was characterized by soft budget constraints. The whole system was slow and did not allow for establishing the balance on customers' (republics) accounts before payment was processed completely. This ineffective system did provide the financing of imbalances between states of the former Soviet Union. The majority of FSU countries (net debtors) were and still are not interested in improving and sufficiently adjusting the payments and settlements system, and this is also the main reason why many attempts to resolve this problem made during meetings of the Commonwealth of Independent States⁹ (CIS) have been finally abandoned. On the other hand, Russian politicians who are against any further deterioration of cooperation among countries of the former USSR could attract the "supporters" of closer relations with Russia only by offering economic support.

After the dissolution of the USSR, Russia began to use the settlements system as an instrument for monitoring its interstate payments imbalances. The economic reforms started in Russia in the end of 1991, did not allow for continued financing of the FSU states on the previous scale. Aiming to impose better monetary control and stop automatic transfer of credit rubles from other CIS states to Russia, a set of bilateral central bank correspondent accounts were created through which payments were not to be processed without funding. However, in mid-1992, the financing of shortfalls in other states generated rapidly growing overdrafts, which forced the CBRF to establish limits on payments imbalances (so-called technical credits). This form of short-term financing was intended to avert the collapse of interstate trade. Technical credits were supposed to be repaid by FSU countries through deliveries of goods. The growing amount of technical credits convinced the Russian government and Supreme Soviet to halt further financing and convert technical credits given in 1992 and 1993 into the official debt of FSU countries. During the spring and summer of 1993 Russia, and debtor countries (including Belarus and Ukraine) started to sign debt repayment agreements.

2.3. Monetary arrangements

Many FSU countries postponed the decision whether to remain in the ruble area or to introduce their own national currencies for quite a long time. The expectation of greater financial support from Russia in the form of subsidized energy import was the main reason for this delay. However, remaining in the ruble area for a longer period of time also had its price. The highest one was connected with the postponement of trade adjustment and macroeconomic stabilization. The longer the period of macroeconomic chaos lasted, the harder would be the measures necessary to stabilize the economy.

⁹ The CIS consists of twelve of the fifteen republics of the FSU (the missing three are the Baltic ones).

Despite various attempts discussed during CIS summits, a common monetary and fiscal policy was never effectively adopted. Very expansive credit policies of individual central banks in 1992 and 1993 (which constituted the main method of financing trade imbalances between FSU states) resulted in inflation "competition" and finally led to the complete decomposition of the common currency area (see Dąbrowski and Antczak, forthcoming). The exchange of the cash rubles in July 1993 (withdrawal of pre-1993 ruble banknotes from circulation in Russia) was the final step towards the establishment of national currencies¹⁰ by all the FSU countries.¹¹ However, some FSU states persisted for quite a long time in their belief in the possibility of rebuilding the ruble area as a viable monetary union, in spite of the obvious unwillingness to accept Russia's conditions for such a union. (These conditions were intended to protect the Russian stabilization effort started in 1992). Belarus belonged to the group trying at the end of 1993 and beginning of 1994 to realize the idea of monetary union with Russia. An agreement on such a union was even signed in April 1994 but never really implemented.

The Ukraine was one of the first newly independent countries to leave the ruble area, doing so in November 1992, just after the Baltic states. Unfortunately, this decision did not help to start a real stabilization policy, and Ukrainian karbovanets collapsed very quickly (see below). In contrast to Baltic countries, the Ukraine left the ruble area because it held the monetary policy of the CBRF to be too restrictive.

¹⁰ It is widely held that monetary "reform" of July-August 1993 was intended to fully isolate Russia from the influences of credit and cash policies of other central banks in the region. The second probable explanation is that this radical step was taken in order to convince the central banks of the FSU countries to accept the CBRF's conditions for the creation of the so-called the Ruble Zone of the New Type.

¹¹ Tadjikistan was the last one to do so, in 1995.

Part II: Transition Policies

1. Domestic and external liberalization

1.1. Domestic liberalization in Russia

The first attempt, at least in theory, to liberalize prices in former USSR was included in the 500 day program in 1990.¹² The first democratic government, formed at the end of 1991 with Deputy Prime Minister Egor Gaidar, considered the freeing of prices from administrative controls as a precondition for reforms. In November and December 1991 a package of legislative acts significantly diminishing state control of prices was prepared (see Dąbrowski et al., 1993).

The first, fundamental step in internal liberalization was taken on January 2, 1992. The operation was, however, not completed. Because of pressure from various lobbies, price controls stayed in force with regard to a wide range of consumer goods (bread, milk, cottage cheese, baby formulas, sugar, salt, margarine, matches, alcohol, petrol, etc.) and some industrial inputs (coal, crude oil, electric energy, all freight charges). Maximum retail margins (of 30%) were imposed as well as administrative controls of prices set by monopolies. The result was that goods sold at regulated prices remained subject to shortages.

The next stage of liberalization was carried out at the beginning of March, when some of the prices still controlled by the state were liberalized and some administrative pricing decisions were moved from central to local levels. The latter affected the prices of consumer goods (bread, milk, etc.) and local transportation charges. In effect some prices were liberalized and some stayed under control.

The third stage of deregulation of prices was initiated by the decree of the President of Russian Federation "On state controls of the prices of some energy sources," which abolished the ceilings on the prices of oil and natural gas as of September 18, 1992. However, the domestic oil and gas prices and the prices charged in exports to FSU countries were below world prices (see below).

The new Prime Minister, Victor Chernomyrdin, tried to return to price controls shortly after taking office. A decree issued on December 31, 1992, called for the introduction of percentage ceilings on the rate of return for many producers of goods classified as essentials (from 10% to 50%). Protests by members of the government, including Deputy Prime Ministers Boris Fedorov and Anatolii Chubais, resulted in a new decree issued on January 18, 1993, abolishing the limits on profit levels for non-monopolistic producers and reducing the number of monopolistic producers whose independence in price setting was restricted.

Finally, in June 1993 coal prices were liberalized and an important part of budget subsidies cut. The same was done for the prices of bread in October 1993. At

¹² In this program, liberalization of prices was left until a later stage of the reform, after mass privatization and financial stabilization.

the end of 1993 all margins imposed on the prices of monopolistic enterprises were abolished.

1.2. Domestic liberalization in Belarus

A fundamental price reform, modelled on the Russian example, was introduced in the end of 1991 and beginning of 1992. The wholesale prices for the bulk of goods and services were freed from administrative control, but limits on the level of profits of monopolistic producers and in the trade sector were applied.¹³ Maximum profit margins amounted to 20% of costs in the state sector and 30% in the private sector. In 1993 these limits affected about one third of industrial goods. Most administratively controlled prices (directly fixed by the government) were changing during 1992 and 1993, but the pace of growth was slower than the inflation level; furthermore, prices for consumer goods were "frozen" after first wave of liberalization at the beginning of 1992. The best example of the results of (administrative) control of prices, which were kept below the market prices, was the level of 5% to 20% coverage costs for prices of consumer goods and transportation charges during 1992-93. The remainder of the prices was covered by budget subsidies.

In 1994, the state still controlled about 5-7% of all retail prices of "essential" goods (bread, milk, etc.). The new president, Alexander Lukashenko, beginning his term in office, made some attempts to reverse the process of liberalization. An example was the decree of December of 1994, lowering the liberalized prices of consumer goods. This decree caused serious shortages of foodstuffs in January 1995.

However, the liberalization process has not been halted. In July 1994 prices for consumer goods were administratively raised to eliminate part of subsidies. The government decree of October affirmed this move and liberalized wholesale prices of foodstuffs. Prices of natural gas and electric energy for industry and the agricultural sector were also deregulated, and as of October 1994 prices for oil and gas fully covered the costs of import. The next decree, issued in November, abolished the limits imposed on profit margins in wholesale and retail trade. In addition, the list of 266 monopolistic enterprises was shortened to 71 enterprises in January 1995.

In 1991, state orders (*goszakazy* - compulsory deliveries for state needs¹⁴) comprised 64% of national production. In 1993, the share of such orders fell to 40% of industrial production and in 1994 to 19% (Macroeconomic Survey of Belarus, 1994). The total amount of goods subject to state orders was cut from a few thousand in the years of the command economy to less than 300 in 1992 and about 30 in 1993. The real level of state orders is difficult to assess, because state supplies are negotiated between the ministries supplying goods and services and the ministries receiving them.

¹³ In addition, in spite of the liberalization of wholesale prices for agricultural products, the Ministry of Agriculture still set minimal prices and agricultural goods are subsidized in many ways (through sales of underpriced inputs, purchases of overpriced outputs, or the extension of bank credits with negative interest rates).

¹⁴ State needs consist of international agreements, military reserves, goods needed in the Chernobyl clean-up, etc.

1.3. Domestic liberalization in the Ukraine

In early January 1992, the Ukrainian government introduced a partial liberalization of prices, accompanied, however, by significant increases in the levels of administered and regulated prices. The latter increases included, at the producer level, prices of coal, crude oil, natural gas, and electricity, and at the retail level, gasoline, diesel oil, coal, gas, electricity, municipal services, and rents. Pressure from the parliament and trade unions resulted in the roll-back of certain increases and a broadening of the scope of price regulation in comparison with initial intentions. On January 31, limits of 25-40% on profitability margins for most goods whose prices had already been deregulated were implemented by presidential decree. Administered prices continued to apply to a number of goods and services. At the producer level, these prices covered coal, crude oil, gas, electricity, freight transport and communication. At the retail level they covered most basic foodstuffs, household fuels, electricity, rents, municipal services and communication.

Agricultural prices were, at least in principle, liberalized in early 1992. In practice maximum procurement prices continued to apply, which made the state the only purchaser of agricultural produce. Various administrative price adjustments were made in March and April (increases in the prices of coal, electricity, transport, and municipal services). In May, retail subsidies for gasoline and diesel oil were abolished. In June, formal subsidies of dairy products at production level were cut; however, subsidies for milk production were still paid to producers. In July, the majority of limits on profit margins were abolished, except for those on especially sensitive goods. In August, the administered prices of domestic crude oil and natural gas were increased significantly.

The second comprehensive price adjustment was implemented in late December 1992 by decree, under the emergency economic powers granted to the government. First, there were significant increases in the levels of administered prices. Second, administered prices for transport charges and oil products at the retail level were abolished. In all these cases administered prices were switched to the regulatory category. Finally, a scheme for the indexation of agricultural procurement prices was introduced for 1993, with indicative prices for deliveries under state orders of a number of products being indexed to the price of agricultural inputs (Święcicki and Wellisz, 1993).

During the first months of 1993, administered prices remained unchanged. In May the government raised substantially most controlled producer prices. Retail prices were also to be raised, but Parliament imposed a moratorium on retail price increases. In early June, it was lifted and the adjustment of retail prices went into effect. Until the end of 1994 no other serious liberalization of prices was made. Only after signing the Systemic Transformation Facility (STF) agreement with the IMF in October 1994 did price liberalization begin on a more serious basis. However, in June 1995 some forms of direct (bread and flour prices on the regional level) and indirect (so-called "enterprise-monopolists" and trade margins for basic products) forms of price control were still retained.

During 1992 state orders (*goszakazy*) covered about 1200 (!) broadly defined categories of goods (75% of turnover in those goods) (IMF, 1993a). The system

began to change at the end of 1992. The main reason was the break-up of retail monopolies. A government decree issued on January 22, 1993 reduced the size of orders to 600 groups (50% of turnover). The new system made a distinction between state orders and state contracts (procurement for the government's own consumption needs). During 1994 the lack of budgetary funds prevented the government not only from paying for state orders but also from fulfilling state contracts. In the 1995 budget, no financial resources were provided for *goszakazy*.

1.4. External liberalization in Russia

The first changes were introduced by the presidential decree "On the liberalization of foreign economic activity in the territory of RSFSR" on November 15, 1992. All enterprises were allowed to purchase foreign currencies, either through foreign exchange auctions or directly from other enterprises. (The system of centralized foreign exchange distribution was not cancelled.) The decree also provided for free access of Russian citizens to foreign exchange offices.

The decree did not deregulate the most important area in external relations, export controls. Export quotas for 17 broad categories of goods (oil and oil products, coal, natural gas, chemical products, timber, pulp and paper, pig iron, non-ferrous metals and products, fertilizers, textiles, medicines, fish, etc.) were maintained. These categories represented about 66% of total export in 1992 (IMF, 1993a). Also, the system of export licences for other than "special" goods (weapons, radioactive materials, precious metals and stones, etc.) did not change significantly and reflected fears of shortages in the market.

Partial liberalization retained the multiple exchange rates of the ruble; e.g., the money market rate, the free-market tourist rate, so called quasi-commercial rate (applied to centralized imports and the mandatory sale of 10% of export revenues in foreign exchange to the CBRF), the special commercial rate (half of the previous one, applied to the mandatory sale of the next 40% of export revenues) and, finally, the so-called official rate (highly overvalued) for settlements of some loans and official transfers.

The export barriers and the segmentation of the foreign exchange market (the cash operation market was fully separated from trade operations) resulted in a weak supply of foreign exchange. The administrative and financial barriers made exporters reluctant to repatriate their profits from abroad, artificially appreciated the ruble exchange rate applied to compulsory sale of export earnings, and caused speculation on the devaluation of the ruble. All this led to the devaluation of the ruble and unjustifiably high exchange rates of foreign currencies on the foreign exchange market.

The system of administrative measures to control export was not very effective, because of the lack of customs borders between Russia and other FSU countries.¹⁵ Pressure from various lobbies gradually led to dilution of the system of export quotas, taxes, and mandatory sale of foreign currency earnings.

¹⁵ Estonia, for example, became one of the biggest exporters of non-ferrous scrap to Western Europe.

Table 6: Foreign Trade with FSU countries and Rest of the World in 1992-1994 (in millions of current U.S. dollars)

Country		1992	1993	1994
Belarus	Exports to FSU	2467.0	2109.1	1610.8
	Exports to ROW	1061.0	832.1	1039.4
	Imports from FSU	-2692.0	-2304.9	-2504.0
	Imports from ROW	-751.0	-911.8	-621.2
Russia	Exports to FSU	18998.0	14000.0	16400.0
	Exports to ROW	38184.0	44400.0	49500.0
	Imports from FSU	-13196.7	-9300.0	-14000.0
	Imports from ROW	-35074.5	-34900.0	-39600.0
Ukraine	Exports to FSU	5308.0	7076.0	5697.0
	Exports to ROW	6000.0	3765.0	4236.0
	Imports from FSU	-6430.0	-9745.0	-7460.0
	Imports from ROW	-5500.0	-2924.0	-2666.0

Source: IMF data; Independent Institute for Socio-Economic and Political Research in Minsk; Ukrainian Economic Trends, TACIS

The regulations concerning import were relaxed to a much greater extent (no import duties were collected until the end of August 1992, and until the end of 1992 no value added tax was levied on imported goods). The artificially high exchange rate of foreign currency was the main barrier to imports.

On July 1, 1992, the second stage of the liberalization of foreign trade began. A uniform market exchange rate of the ruble against foreign currencies was introduced. As of September 1, 1992, the unified rate was also applied to credit operations. However, for some "sensitive" imports (foodstuffs, medicines), the artificially appreciated ruble exchange rate was in use. In the first half of 1992 the privileged imports accounted for about 40% of total imports, but in the second half this share declined to about 10% (see Dąbrowski et al., 1993).

In July 1992 the government began to use the market rate for the entire portion (50%) of foreign exchange export proceeds subject to mandatory sale. On August 1, 1992, a 15% import duty was introduced, and from the beginning of 1993 value added tax was collected on imported goods.

During 1993 and 1994 the number of types of goods subject to export quotas was declining (in January 1994 export quotas were applied to 14 types of goods), and the differences between domestic and external prices were narrowing. According to many agreements between the Russian government and the IMF, most export barriers should have had been cancelled. In spite of this, in 1993 and 1994 the amount and weight of measures to administer external trade rose. Besides the system of export quotas and differentiated export duties, three additional barriers gained in significance: the export licensing procedure, centralized import, and import tariffs. Centralized import was finally abolished on January 1, 1994. The procedure for

granting a limited number of export licences was from the very beginning highly questionable and still constitutes a battle field for different lobbies. Finally, all export barriers should be abolished after the signing of the stand-by agreement with the IMF in March 1995.

Due to the growing purchasing power of Russian consumers combined with the easy access to foreign exchange and openness in trade, the importance of import barriers is growing. As mentioned above, before July 1, 1992, there were no import charges. On that day a 5% import tax was introduced. On September 1, 1992, this tax was raised to 15%. On April 1, 1993, a new list of goods subject to import duties was drawn up. The highest import charges amounted to 100%. Subsequent changes raised import duties, mostly on consumer goods. The direction of changes suggest that interests of various lobbies in the industrial and agricultural sectors are to be protected.

1.5. External liberalization in Belarus

According to the IMF, Belarus was the republic with the biggest share of inter-republican trade in GDP in 1988. This "openness" in trade within the USSR was not transformed into a liberal foreign trade policy after the dissolution of USSR. Until the end of January 1992, all the old Soviet exchange rates (mentioned above) were still in use. During the whole year 1992 the National Bank of Belarus (NBB) kept in force the system of multiple exchange rates. The mandatory surrender of part of exporters' revenues introduced in April 1992 and modified in 1993¹⁶ constituted a form of implicit taxation of export and subsidization of centralized government import. During 1992 changes in the administered exchange rates narrowed the gap between them and market rate. Enterprises not allowed to use administered exchange rates could negotiate rates with commercial banks. Based on the weighted average of such transactions, NBB calculated the so-called market rate.

In January 1993, the special exchange rate was replaced by an investment rate (for obligatory surrender and direct foreign investment) and the commercial rate was replaced by the unified NBB rate (calculated on the weighted average). Since that time there were two official (government) exchange rates. However, in March 1993 obligatory sale of 100% of "soft currencies"¹⁷ was introduced for the purpose of collecting currencies for interstate payments.

The dominant position in Belarussian foreign trade is occupied by state bodies. This especially concerns trade with FSU countries (mostly with Russia). The system of export quotas and licences, very similar to Russia's, covered 186 goods in the middle of 1994. In December 1994 this list was cut to 66 items. A system of centralized export and import of "sensitive" goods (grains, vegetable oil, sugar, dairy products, medicines, etc.) also functions in Belarus.

¹⁶ Exporters to countries outside the FSU have to pay a 10% tax in foreign currencies from export revenues and surrender an additional 20% of export revenues using an artificially appreciated Belarussian ruble exchange rate.

¹⁷ New currencies of the countries of the FSU.

In November 1994 the government and the NBB issued a few decrees further deregulating the currency exchange regime. The quota of "soft currencies" subject to obligatory sale was reduced to 50%, and individuals and enterprises were given the right to hold "soft currencies" in their bank accounts. Commercial banks also received the right to buy foreign currencies on their behalf.

1.6. External liberalization in the Ukraine

During 1992-93 Ukrainian trade was organized within the system of intergovernmental agreements (bilateral agreements have been signed with all except one of the FSU countries). Trade was to be implemented through the mechanism of quotas and state orders. On December 26, 1992, a decree "On the Special Export Regime for Certain Types of Goods" was issued. This decree stipulates that export of coal, non-ferrous ores, metals, waste, and scrap, ores of precious metals, oil and oil products, gas, electricity and spirits can be carried out only by companies with a special permission from the cabinet (usually, only state-owned enterprises qualify).

Until the end of March 1993, there were three exchange rates: an official rate (a highly appreciated rate used for legal and accounting purposes), a commercial rate used for trade, and the market rate. Following the decision of the CBRF closing the Moscow Interbank Currency Exchange (MICEX) for foreign entities as of June 15, 1992, the NBU began its own weekly U.S. dollar auction on September 1992. This Ukrainian Interbank Currency Exchange (UICE) auction rate was based on the rates of transactions in the banking system. The Ukrainian authorities continued, however, to set an official exchange rate based on MICEX rate, or on the local auction rate when it appreciated more than the one in Moscow. The withdrawal of the Ukraine from the ruble area in November 1992 revealed other "market" exchange rates set on the basis of commercial bank, NBB, or MICEX rates. This situation changed on March 16, 1993, when official rate was unified with the UICE auction rate.

In 1993 decrees deregulating export activities were issued. Firms were allowed to export irrespective of the quota system by paying an export tariff (from 5 to 30%). Firms could also purchase quotas at auctions. However, in 1993 the export system as a whole remained restrictive and complicated (with many loopholes for the well-informed). The trade decree issued in January 1993 expanded the number of goods subject to quotas, introduced a new mechanism to centralize convertible currency exports, and added a new category of "strategic exports." The amount of goods covered by quotas rose from 180 in 1992 to 390 in 1993. Licenses were also necessary for all exports except manufactured goods. The import regime from the beginning was much simpler. There are no nontariff barriers, except for standard rules. In January 1993, a system of low import duties was introduced.

Under the pressure of expansionary monetary policy, the unified exchange rate depreciated steadily against both the U.S. dollar and the Russian ruble in the first half of 1993. On August 18, the UICE auction rate and official rate were separated. The official rate became fixed. In November quotations at the UICE were suspended and NBU tenders begun. In October 1994 the UICE resumed auctions, and from October 24, the official rate was unified again with the UICE auction rate.

In the Stand-by Agreement with the IMF, the Ukrainian government stated that it will eliminate all remaining export quotas and licences except those on grain and goods subject to voluntary export restraints. On the other hand, the Ukrainian government started to introduce import barriers such as higher import duties and in January 1995 reintroduced import licences.

2. Macroeconomic policy

Macroeconomic policy in all three countries was rather weak (Russia) or even very weak (the Ukraine until the end of 1993, Belarus from the middle of 1993) during the period under analysis. All three countries failed to stabilize their economies and even faced the danger of hyperinflation (Russia at the end of 1992, the Ukraine at the end of 1993, Belarus at the end of 1993 and beginning of 1994). This situation was influenced by many factors, but two important economic determinants play a very important role here: the failure to make radical and immediate liberalization at the very beginning of transition process and continuing traditional state paternalism in relation to SOEs and collective agriculture.

The failure to complete domestic liberalization has had direct fiscal and quasi-fiscal consequences. Continuing price control makes it necessary to provide subsidies, tax exemptions, and heavily subsidized credit from the central bank (the last component creating a quasi-fiscal deficit not recorded officially by fiscal statistics). It also decreases budget revenue from the profit tax and VAT. Similar consequences result from the maintenance of the system of state orders (*goszakazy*) and other forms of obligatory deliveries. Multiple exchange rate practices mean an additional export tax on one hand and the hidden subsidization of preferred import (such as grain and medicines in Russia in the first half of 1992 or energy in the Ukraine in 1993-1994) on the other. Import was also often subsidized using foreign credit (Russia 1992-1993). Export quotas and licensing decrease the potential profit of exporters (especially in the case of the oil and gas industry in Russia) and possible tax revenues of the budget. Helping to maintain the artificially undervalued exchange rate, they lead indirectly to import subsidies.

The level of state paternalism¹⁸ toward SOEs and *kolkhozes* increased in comparison with the past. Although SOEs under the traditional command system could expect the government to bail them out in cases of financial crisis, they (and especially their managers) were subject to quite rigorous control and discipline imposed both by the state administration and the party apparatus. After the collapse of the communist system this control disappeared. Moreover, "red" directors became a powerful lobby in the newly elected parliaments (see concluding remarks), successfully fighting for direct subsidies, tax exemptions, government investment programs, inter-enterprise debt clearing operations, state financing of additional working capital, and other forms of cheap credit. This pressure was relatively much stronger in the cases of Belarus and the Ukraine than in Russia because of political factors (see concluding remarks) and the slower pace of the privatization program.

¹⁸ The idea of state paternalism in relation to the SOE is extensively discussed by Kornai [1980].

Table 7: Fiscal data for Belarus, Ukraine, and Russia (in percent of GDP)

Belarus					
		1991	1992	1993	1994
<i>Central Budget</i>					
Revenues		38.5	30.9	28.6	29.6
Expenditures		36.5	32.9	33.0	32.2
Balance		2.0	-2.0	-4.4	-2.6
<i>General Government Budget</i>					
Revenues		47.5	43.3	43.6	36.6
Expenditures		43.9	46.8	51.9	38.1
Subsidies		...	11.0	12.4	7.1
Balance		3.6	-3.5	-8.3	-1.5

Ukraine					
<i>Central Budget</i>					
Revenues		36.5	41.5	41.1	45.0
Expenditures		50.6	71.9	51.2	55.0
Balance		-14.1	-30.4	-10.1	-10.0
<i>General Government Budget</i>					
Revenues		38.3	44.0	42.4	44.9 ^a
Expenditures		51.9	73.3	52.1	53.0 ^a
Subsidies		...	9.1	5.5	9.1 ^a
Balance		-13.8	-29.3	-9.7	-8.1 ^a

^a -January-June

Russia					
		1991	1992	1993	1994
<i>Federal Government Budget</i>					
Revenues		23.6	16.6	13.7	11.0
Expenditures		22.8	27.4	20.3	21.9
Balance		-0.8	-10.7	-6.7	-10.9
<i>Local Government Budget</i>					
Revenues		...	17.6	15.7	17.5
Expenditures		...	17.0	16.0	17.0
Balance		...	0.6	-0.3	0.5
<i>Extrabudgetary funds balance</i>					
		-2.2	2.5	0.6	0.5
<i>Unbudgeted import subsidies</i>					
		-4.2	-11.9	-2.1	...
<i>General Government Budget</i>					
Subsidies		...	8.9	8.6	7.5
Balance		-5.7	-18.8	-7.6	-9.9

Source: IMF data; Independent Institute for Socio-Economic and Political Research in Minsk; Ukraine Numbers (TACIS); Ukraine in Numbers by Michael Zienchuk

Though generally all three countries have had problems with balancing their fiscal accounts, table 7 shows us that the size and trends of fiscal deficits in each country were different. The Russian Federation¹⁹ and the Ukraine were running

¹⁹ If we take into consideration the huge deficit of the all-union budget of the USSR which was *de facto* assumed by the Russian Federation, the total fiscal deficit of this country in 1991 was far greater (see part I).

serious fiscal deficits as early as 1990, at which time Belarus recorded fiscal surpluses both in the central budget and in general government accounts. The same differences were repeated in 1992: the Ukraine ran an enormous fiscal deficit of 30.4% of GDP (central budget) or 29.3% of GDP (general government), followed by Russia, with deficits of 10.7% of GDP (federal government) and 18.8% of GDP (general government). Belarus recorded a deficit of only 2% of GDP (central budget) or 3.6% of GDP (general government). The latter country seemed to be successful in maintaining some kind of financial discipline especially in respect to social programs and enterprise financing. Given the very limited progress of systemic reforms in Belarus, this should be seen as a sort of continuation of the traditional control and discipline typical for the centrally planned economy. This collapsed during the next year as a result of political decomposition (the beginning of the presidential election campaign of Prime Minister Vyacheslav Kebich) and external shock (serious real adjustment of oil and gas import prices). In 1993 Belarus recorded a deficit of 4.4% of GDP (central budget) and 8.3% of GDP (general government). The Ukraine's deficit amounted 10.1% of GDP (central budget) or 9.7% of GDP (general government). Russia's deficit amounted 6.7% of GDP (central budget) or 7.6% of GDP general government. The next year (1994) brought an improvement of the Belarussian situation (deficit on the level of 2.6% of GDP and 1.5% of GDP respectively), a worsening of Russian fiscal accounts (10.9% and 9.9%), and stabilization of the size of Ukrainian deficit (ca. 10% of GDP in the case of the central budget).

The above characteristics gives us a picture of the different tracks of fiscal policy in each country. We have already mentioned Belarus's relative fiscal austerity (with the exception of the second half of 1993 and the beginning of 1994). In 1991 and 1992, the Ukraine represented the extreme case of post-communist macroeconomic populism, without any real control of government spending. In the beginning of 1993 the Kuchma-Pynzenyk government tried to impose some fiscal discipline, which resulted in a smaller budget deficit, especially in the first quarter of the year. Later this policy collapsed, and both Pynzenyk and Kuchma left the government. At the beginning of 1994 fiscal and monetary policies were toughened again, resulting in a significant decrease of the inflation rate in the spring and summer of that year. Unfortunately, the summer of 1994 brought the next loosening, brought to a halt in the last quarter of 1994, when the Ukraine signed the STF agreement with the IMF and started a more comprehensive stabilization policy (with a fiscal deficit of 3.3% of GDP planned for 1995).

Russia attempted to stabilize its economy at least three times (the fourth attempt has been underway during the spring of 1995). The Gaidar team was successful in balancing the central budget for the first four months of 1992 but later lost control over both the expenditure and the revenue side. Boris Fedorov tried to discipline fiscal policy in 1993 with moderate success. However, this effort did not suffice to reduce inflation to a monthly level below 10% (Fedorov's effort was never really supported by the CBRF). During the next year the Chernomyrdin government tried to stabilize again (with the support of the second tranche of STF) but the final fiscal result was worse than that of the previous year. In 1995 First Deputy Prime Minister Anatolii Chubais is repeating the stabilization effort, which includes a budget deficit target not exceeding 6% of GDP.

Table 8 illustrates the large role of producer subsidies in creating fiscal tensions. In practice the entire fiscal deficit can be explained by this factor. The relatively high level of subsidies reflects both the shortcomings of the liberalization process and the state paternalism toward the enterprise sector.

Table 8: Total producer subsidies as % of GDP (1992-1994)

Country	1992	1993	1994
Belarus	11.0	12.4	7.1
Russia	8.9	8.6	7.5
Ukraine	9.1	5.5	9.1 ^a

^a January-July

Source: IMF data

Monetary policy is the second standard pillar of any stabilization effort. In the case of post-communist economies, especially in the initial stage of the transition process, monetary policy is strongly influenced by the fiscal situation because money creation is the only really available source of deficit financing.

Table 9 shows the quarterly and monthly average trends of the money supply in each country. There can be no doubt that monetary policy has been expansive or even very expansive during the entire period under analysis in all three countries. This is true even of periods when the fiscal policy was relatively tight. This means that the money supply was determined not only by the financing of the budget deficit; it shows indirectly that central banks have also played an important quasi-fiscal role by providing SOEs and collective farms with cheap credits. These credits usually carried interest rates far below the inflation rate and were rarely repaid to the central banks. In practice they have not differed very much from standard budget subsidies. Therefore we must interpret the formal fiscal statistics with great caution. Very often the central bank and its credit emission have simply played the role of an alternative source of public sector expenditures. This kind of policy substitution is evident, for example, in the case of Belarus in 1994.

Beginning in the fourth quarter of 1993 the CBRF started to slow down the pace of monetary expansion from the monthly average of 15-20% (or even 35% in the third quarter of 1992) to a level of 5-10%. The NBU also reduced somewhat the rate of monetary expansion in the last quarter of 1993 and the first half of 1994, thus avoiding the danger of hyperinflation which really existed at the end of 1993. In contrast, the activity of the National Bank of Belarus, which had been relatively responsible in 1992, became far more expansionary in following years.

The limited size of this paper does not allow us to make a more detailed analysis of the central banks' credit activities. However, one specific item is worth mentioning: the financing of the ruble area by the CBRF in 1992-1993 (see Dąbrowski and Antczak, forthcoming). In the first half of 1992 this occurred through unlimited automatic financing of the active balances of the ruble area countries on their correspondent accounts with the CBRF. In July 1992, the legal form of this financing was changed, into so-called technical credits granted by the CBRF to other

Table 9: Quarterly and monthly money supply percentage changes for Belarus, Russia, and Ukraine in 1992-93

Country		1992				1993				1994			
		Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.
Belarus	M3 quarterly % change	40,96	26,63	52,83	74,57	94,65	93,63	71,98	62,88	112,34	89,25	103,09	134,98
	M3 monthly aver. % change	12,12	8,19	15,19	20,41	24,86	24,64	19,81	17,66	28,53	23,69	26,64	32,95
	M0 quarterly % change	8,43	-49,93	108,86	68,65	99,20	150,77	106,71	25,64	82,84	132,83	80,96	98,67
	M0 monthly aver. % change	2,73	-20,59	27,83	19,03	25,82	35,86	27,39	7,90	22,28	32,54	21,86	25,71
Russia	M3 quarterly % change	35,29	72,93	146,88	52,04	59,64	68,85	38,22	18,25	31,05	33,01	30,47	27,50
	M3 monthly aver. % change	10,60	20,03	35,15	14,99	16,87	19,08	11,39	5,75	9,43	9,97	9,27	8,43
	M0 quarterly % change	38,73	86,67	120,98	69,49	52,50	99,80	64,46	58,21	19,51	49,69	26,05	21,67
	M0 monthly aver. % change	11,53	23,13	30,25	19,23	15,10	25,95	18,04	16,52	6,12	14,39	8,02	6,76
Ukraine	M3 quarterly % change	42,84	107,03	62,33	99,70	135,21	84,86	177,41	55,70	43,72	59,25	71,58	71,51
	M3 monthly aver. % change	12,62	27,45	17,52	25,93	32,99	22,73	40,51	15,90	12,85	16,78	19,72	19,70
	M0 quarterly % change	79,88	177,30	103,56	40,73	86,34	86,89	208,32	146,22	80,38	44,47	56,27	51,92
	M0 monthly aver. % change	21,62	40,49	26,74	12,06	23,05	23,18	45,55	35,03	21,73	13,05	16,04	14,96

Source: IMF data; Independent Institute for Socio-Economic and Political Research in Minsk; Ukrainian Economic Trends, TACIS; authors calculations

CIS states and overdrafts on those countries' correspondent accounts. In this way the CBRF provided financing to other CIS states (mainly the Ukraine, Belarus, Kazakhstan, and other Central Asia NISs) amounting to 8.2% of Russian GDP in 1992 and 3% of Russian GDP in 1993 (IEA, 1995, table 1.4.). In the second half of 1993 this form of external financing was stopped. Due to the specific institutional arrangements existing in 1992-1993 in the ruble area, the Ukraine and Belarus could "export" some of the inflationary consequences of their expansionary monetary policies to Russia. This was especially true of the Ukraine, which was the 'leader' in organizing the subsequent inter-enterprises debt clearing operations.

The analyzed countries did not use other instruments of macroeconomic stabilization. They did not have any restrictive income policies. Only Boris Fedorov in Russia tried to use a fixed exchange rate in the second half of 1993 to stabilize the ruble but this policy was rather weak and lasted only a few months.

3. Privatization, restructuring, and institutional reforms

3.1. Privatization

On the privatization front, Russia has left the two other analyzed countries far behind. In spite of its unsuccessful stabilization (see previous section) and incomplete liberalization (especially external - see section 1), the Russian government has begun a very ambitious privatization program. It included:

1. Small privatization, based on the sale for cash (through public auction) of state assets, mainly stores, repair shops, small enterprises. This process, initiated with the help of IFC (International Finance Corporation) experts in Nizhnii Novgorod in the beginning of 1992, spread very quickly throughout the territory of Russia.
2. Mass corporatization of most of the medium-size and large state enterprises. The main effort of this process occurred in the fall of 1992 and beginning of 1993.
3. Emission of privatization vouchers for all citizens of the Russian Federation on October 1, 1992. The voucher was a bearer instrument, and was easily transferable.
4. The so-called "large" privatization of enterprises which had previously undergone corporatization, according to three models, varying by the extent of privileges to insiders (management and employees). In each of these methods the voucher plays an essential role. The voucher privatization process was initiated in December 1992, gained significant pace in 1993, and was completed on June 30, 1994. The second method, giving the largest preferences to the employees, was definitely the dominant one. It has been utilized in about two thirds of privatized enterprises (Jermakowicz, Pańków, and Abramov, 1994). On July 1, 1994, voucher privatization was replaced by a more traditional commercial privatization (i.e., selling shares for cash), with preference given to strategic investors offering serious restructuring plans. However, the pace of large privatization in this stage has been far slower than during the voucher period.
5. The formation of open mutual funds, receiving privatization vouchers (and cash) from citizens and investing in enterprises undergoing privatization on their

behalf. The process of formation of the funds was initiated in the first months of 1993, and gained pace during the late spring and summer of that year.

6. The spontaneous emergence of new private firms, mainly in trade and services (including street trade).²⁰ Some of the newly forming private firms do business in the so-called second economy, meaning that their activity is partially or entirely unregistered.
7. The formation of firms with participation of foreign capital (*sovmestnye predpriyatiya*). This process is not yet very advanced. It is concentrated mainly in trade, services, and small-scale manufacturing as well as in certain regions (Moscow, St. Petersburg, the Far East).
8. The initiation of agricultural privatization, authorized by a special decree of President Yeltsin at the end of October 1993. Earlier, transformations in agriculture were effectively blocked politically by a strong *kolkhoz-sovkhos* lobby in the Supreme Soviet, which did not allow the passage of constitutional amendments and bills allowing land turnover. This problem was finally solved by the new constitution of December 1993. However, after key reformers such as Gaidar and Fedorov left the government in January 1994 the development of the private sector in agriculture was stopped again.

The complex and consistent policy of the State Committee for the Management of State Property headed in 1992-1994 by Anatolii Chubais allowed Russia to achieve, in a relatively short period of time, significant quantitative results in the privatization sphere, placing it in the position of a definite leader among post-Soviet countries, and perhaps even in comparison to certain Central and Eastern European countries. Statistically, more than 50% of Russian GDP is produced by the private and privatized sector.

Denationalization appears to be irrevocable in Russia. It also indirectly contributes to the weakening of the traditional branch structures of management and the relics of the command economy system. The qualitative characteristics of Russian privatization are controversial, however. The most frequently mentioned reservations are:

1. The corporatization and "large" privatization processes were not preceded by a deconcentration of the existing state enterprises, especially in industry and foreign trade; in addition, the authorities often failed to eliminate various regulations giving them monopolistic rights. A danger thus exists that many state monopolists will be transformed into private ones, and can also make the process of structural changes at the enterprise level more difficult.
2. Privatization was and is being performed in conditions of high inflation, a not fully liberalized economy, and very imperfect competition (especially by foreign competitors). This creates the threat that the participants of the privatization process will make erroneous investment decisions and that many privatized enterprises will go bankrupt in the future. Formally privatized enterprises are still

²⁰ There is, however, a lack of credible statistical data concerning this process.

functioning under "soft" budget constraint conditions. This increases the likelihood of the appearance of strong rent-seeking groups in the private sector opposed to consistent stabilization, the hardening of budget constraints for enterprises, and the liberalization of the Russian economy.

3. Both the small and large privatization processes have so far given immense advantages to insiders (i.e., management and employees), who have, for the most part, not changed since the collapse of the previous system (in contrast to, for example, the far-reaching personnel changes among directors of state enterprises in Poland in 1990-1991). This casts into doubt the ability of privatized enterprises to make deeper adjustments such as the reduction of excessive employment.
4. Similar doubts are also raised by the threat of excessive dispersion of property rights as a result of strong preferences for employees and the broad distribution of vouchers to the population. Because of these factors, a distinct strategic investor interested in increasing profits might not appear in privatized enterprises. The designers of the Russian privatization program intended the spontaneously emerging investment funds to act as a counterbalance to the tendencies of excessive share dispersion. However, many of these funds had a strongly speculative character and some of them (e.g., MMM) even behave like typical financial pyramids. Such practices strongly undermined the credibility of the investment funds. The Security and Exchange Commission was created only at the beginning of 1995 and the relevant legislation is in the final stages of preparation in the Duma and the Federal Council in June 1995.

Generally speaking, Russia had to rely on non-equivalent methods of distribution of state-owned assets, at least temporarily giving up restructuring targets. Alternative solutions such as East German massive commercial privatization (organized by the *Treuhand*) or Polish and Hungarian multi-track approach were not feasible economically or politically. The political window of opportunity for mass privatization was very narrow and was utilized very adeptly by Anatolii Chubais.

The qualitative weaknesses of the Russian privatization do not mean that this country lost a chance for substantial restructuring, as the concentration of diluted ownership will progress in the future. There is also hope that investment funds created on a voluntary basis can play a significant role in the restructuring process. Since mass privatization is based on individual, exclusive, and fully transferable property rights, it does not exclude prospects for real private ownership control in privatized enterprises. In the case of Russia, the final result of mass privatization will strongly depend on the macroeconomic stability and effective liberalization of its economy (see the two previous sections) and on the ability of the Russian state to provide economic agents some basic public goods such as effective protection of property rights, public enforcement of private contracts, public security, etc.

As mentioned earlier, the Ukraine and Belarus lagged far behind Russia in their privatization policies. From 1992 to 1994 only very limited local experiments with small-scale privatization took place in both countries. The few large privatization projects carried out consisted mainly of cases of strongly leveraged management

buyouts. The late *perestroika* system of collective leasing (*arenda*) was continued in both countries. Of course, the lack of an official privatization policy did not stop the unofficial or even illegal *nomenklatura* type of privatization, manifested by the earlier mentioned hidden transfers of profits and assets from SOEs to private firms.

At the very end of 1994 the Ukraine finally initiated a comprehensive and ambitious privatization program supported by a World Bank rehabilitation loan program which has contained:

1. acceleration of small-scale privatization;
2. implementation of the one-step mass corporatization of SOEs together with the transfer of state property rights from the branch ministries to the State Property Fund responsible for the privatization policy;
3. launching of mass privatization, a voucher-type program based on a combination of the Russian and Czech programs (the strong limitation of privileges for employees is the main difference from the Russian scheme);
4. spontaneous creation of investment funds and preparation of regulations of the security market.

At the time of writing (June 1995), it is still too early to assess the final results of the new Ukrainian privatization approach. It does, however, look very promising so far.

In Belarus, despite some progressive changes in privatization legislation and in the government privatization program (which also includes voucher-type mass privatization), this process has not really started yet (see Antczak, Kozarzewski, and Połomski, 1995).

Agriculture privatization is proceeding very slowly in all three countries. The traditional Soviet-type *kolkhozes* and *sovkhoses* (sometimes converted formally into joint-stock companies) still dominate this sector. Real private farms still play a very marginal role and their number increase very slowly. By the end of 1994, 279,000 private farms were registered in Russia, with an average size of 43 hectares, occupying 5% of total agricultural land (IEPPP, 1995, p. 115). In the first quarter of 1995, 33,000 private farms were registered in the Ukraine, with an average size of 22 hectares, occupying 1.8% of total agricultural land (Ukrainian Economic Trends, April 1995, pp. 52-53). Belarus has the worst figures, with only 2,000 private farms at the end of 1992, producing about 1% of agricultural output (Antczak, Kozarzewski, and Połomski, 1995). (The situation has not changed significantly since then.)

3.2. Microeconomic restructuring and institutional reforms

Measuring the progress of microeconomic restructuring is a very difficult task. We can rely only on some indirect indicators such as unemployment rate, remembering, however, that the latter is also influenced by many other factors such as the tightness of social regulations (e.g., ease of access to unemployment benefits), by the size of external shocks, etc. Bearing in mind these limitations and looking at table 10, we see that the FSU countries have generally lower unemployment rates than CEE countries (excepting the Czech Republic). The interpretation of this fundamental difference is not easy. There is a plausible hypothesis (see, e.g., Layard and Richter, 1994) that the FSU countries have a more flexible labor market and less social

guarantees than CEE ones. However, taking into consideration the enormous size of structural shocks (external and domestic) experienced by FSU countries in comparison with their CEE neighbors (which would imply higher unemployment and not lower), the labor market factor cannot explain all the difference. It is quite clear that FSU countries, especially CIS ones, lag significantly behind CEE in respect to microeconomic restructuring. Among the three analyzed countries Russia seems to be the most advanced in this process. The available results of microeconomic research (see, e.g., Evseeva-Boeva and Dolgopiatova, forthcoming) show that some kind of market-oriented microeconomic adjustment can be observed in Russian enterprises. There is little evidence that similar processes are equally advanced in the Ukraine and Belarus.

Table 10: Unemployment rates as percentage of labor force (end of year) in selected East European countries

Country	1989	1990	1991	1992	1993
Poland	0.1	6.1	11.8	13.6	15.7
Czech Republic	0.0	0.8	4.1	2.6	3.5
Slovakia	0.0	1.5	11.8	10.4	14.4
Hungary	0.3	2.5	8.0	12.3	12.1
Estonia	0.0	0.0	0.1	1.9	2.6
Latvia	0.0	0.0	0.1	2.1	5.3
Russia	0.0	0.0	0.1	4.8	5.5
Belarus	1.0	1.0	1.0	0.5	1.5
Ukraine	0.0	0.0	0.0	0.3	0.4

Sources: Transition report, EBRD, 1994; Statistical Handbook for FSU, 1994; Russian Economic Trends, 1994; PlanEcon

Russia is also the most advanced in the field of institutional reforms, especially with respect to financial market legislation and corporate law. The Ukraine is second and Belarus third in this ranking. If we look at the actual development of the financial sector in the broad sense (commercial banks, investment funds, insurance companies, stock exchanges, foreign exchange market, interbank credit market, securities market, etc.), Russia is the leader in comparison with the two other analyzed states. In each country, however, the financial market is concentrated mainly in the capital city, with a real "desert" in the regional and smaller city centers. We must also remember that the quality of financial services is generally not very high (excepting a few of the biggest Moscow banks) and the assets portfolio in many cases very doubtful. So far high inflation and regular injections of subsidized credits have helped to prevent a liquidity crisis in the banking sector. In the coming months, however, with inflation expected to come down and strongly positive real interest rates, we may expect a serious banking crisis in Russia and the Ukraine.

Part III: Macroeconomic Performance

In this part we will discuss the inflation and exchange rate performance as well as GDP trends in each country. This does not, of course, constitute a full picture of macroeconomic situation, but it allows us to learn about the consequences of adopted policies.

1. Inflation and money velocity

Table 11 and chart 1 illustrate the inflation record of each country. Generally, all three countries failed to bring inflation under control, which corresponds very well with the monetary statistics (see section II.2). There is no doubt that expansionary monetary policy must be seen as the primary source of very high inflation in the analyzed countries. Although Russia and the Ukraine were able to decrease the inflation rate to a monthly level of 4-5% in the summer of 1994, the lack of progress in monetary control made this success only temporary. Generally, the inflation rate has followed (with a 3-4 month time lag) the rate of money growth. Money velocity (see table 12) shows an increasing trend, though with some fluctuation.²¹ The relatively limited acceleration of money velocity might be surprising, given the high rate of nominal money expansion and thus of seigniorage. In more market oriented economies such as those of Latin American countries such high rates of money creation would probably lead to hyperinflation very quickly. Economic agents in the FSU are less experienced with high inflation and more ready to pay the inflation tax. The underdeveloped financial sector and dominance of SOEs has also made the analyzed economies less vulnerable to the damage created by the inflation tax.

After the initial price adjustment in January 1992, the Ukraine has had the highest cumulative inflation record with a short hyperinflation episode in the second half of 1993. Belarus was second in this ranking, balancing in the second half of 1993 and all of 1994 on the verge of hyperinflation. Russia has the lowest cumulative inflation, with a general decreasing trend, though with periodic resurgence of the inflation rate. Even Russia is far behind the Baltic and Central European standards, not to mention Western norms of inflation.

2. Nominal and real exchange rate

A very similar picture is shown in chart 2. All three currencies have the same starting point - the old Soviet ruble. Already in January 1992 each country recorded a different market exchange rate, though they had still the same currency. The sources of these differences probably lay in the different extent of price liberalization, different multiple exchange rate practices, and different levels of development of financial markets and their segmentation between countries. However, the differences in the pace of monetary expansion became a main determinant of exchange rate

²¹ The money velocity data must be treated, however, with some caution because of low quality of quarterly GDP statistics.

Table 11: Consumer Price Indexes for Belarus, Russia, and Ukraine in 1991-1995 (first quarter)

	1991			1992			1993			1994			1995		
	Belarus	Russia	Ukraine	Belarus	Russia	Ukraine	Belarus	Russia	Ukraine	Belarus	Russia	Ukraine	Belarus	Russia	Ukraine
January	5.9	6.2	3.7	181.0	245.0	285.2	14.8	26.0	73.2	40.7	17.9	19.2	39,2	17.8	21.2
February	11.5	4.9	4.7	51.8	38.0	15.3	19.7	25.0	28.8	18.7	10.8	12.6	33,7	11.0	18.1
March	3.9	6.3	8.4	18.1	30.0	12.1	28.1	20.0	22.1	10.2	7.4	5.7	20	10.0	11.4
April	507	63.5	66.4	18.5	22.0	7.6	24.7	19.0	23.6	28.6	8.5	6.0			
May	3.4	3.0	1.2	16.8	12.0	14.4	19.6	18.0	27.6	28.7	6.9	5.2			
June	2.5	1.2	0.8	12.9	19.0	26.5	26.3	20.0	71.7	19.5	6.0	3.9			
July	2.0	0.6	0.5	12.8	11.0	22.1	23.2	22.0	37.6	26.6	5.3	2.1			
August	0.4	0.5	0.3	8.7	9.0	8.3	25.1	26.0	21.7	53.4	4.6	2.6			
September	0.7	1.1	2.5	9.1	12.0	10.6	36.0	23.0	80.3	25.5	7.2	7.3			
October	3.7	3.5	6.3	14.2	23.0	12.4	44.6	20.0	66.1	25.7	11.8	22.6			
November	6.6	8.9	7.4	22.7	26.0	22.0	43.2	16.0	45.3	40.5	14.2	72.3			
December	10.7	12.1	10.7	30.1	25.0	35.1	45.5	13.0	90.8	31.3	16.4	28.4			

Source: IMF data; Ukrainian Economic Trends, TACIS

Table 12: Velocity of Broad Money in Belarus, Russia, and Ukraine (quarterly GDP/ end-of-period M3)
(Percent change over previous month)

Country	1992				1993				1994			
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.
Belarus	1,00	1,26	1,22	1,48	0,69	0,34	0,63	1,60	0,99	1,05	1,77	2,27
Russia	0,86	0,83	0,54	0,62	0,93	1,05	1,12	1,55	1,54	1,74	1,58	1,68
Ukraine	1,37	1,24	1,09	0,92	1,01	1,09	1,13	1,89	2,17	1,75	1,30	1,59

Source: IMF data; Independent Institute for Socio-Economic and Political Research in Minsk; Ukrainian Economic Trends, TACIS; authors calculations

Chart 1

CPI monthly percentage changes over the previous period for Belarus, Russia, and Ukraine in 1991-1995 (first quarter)

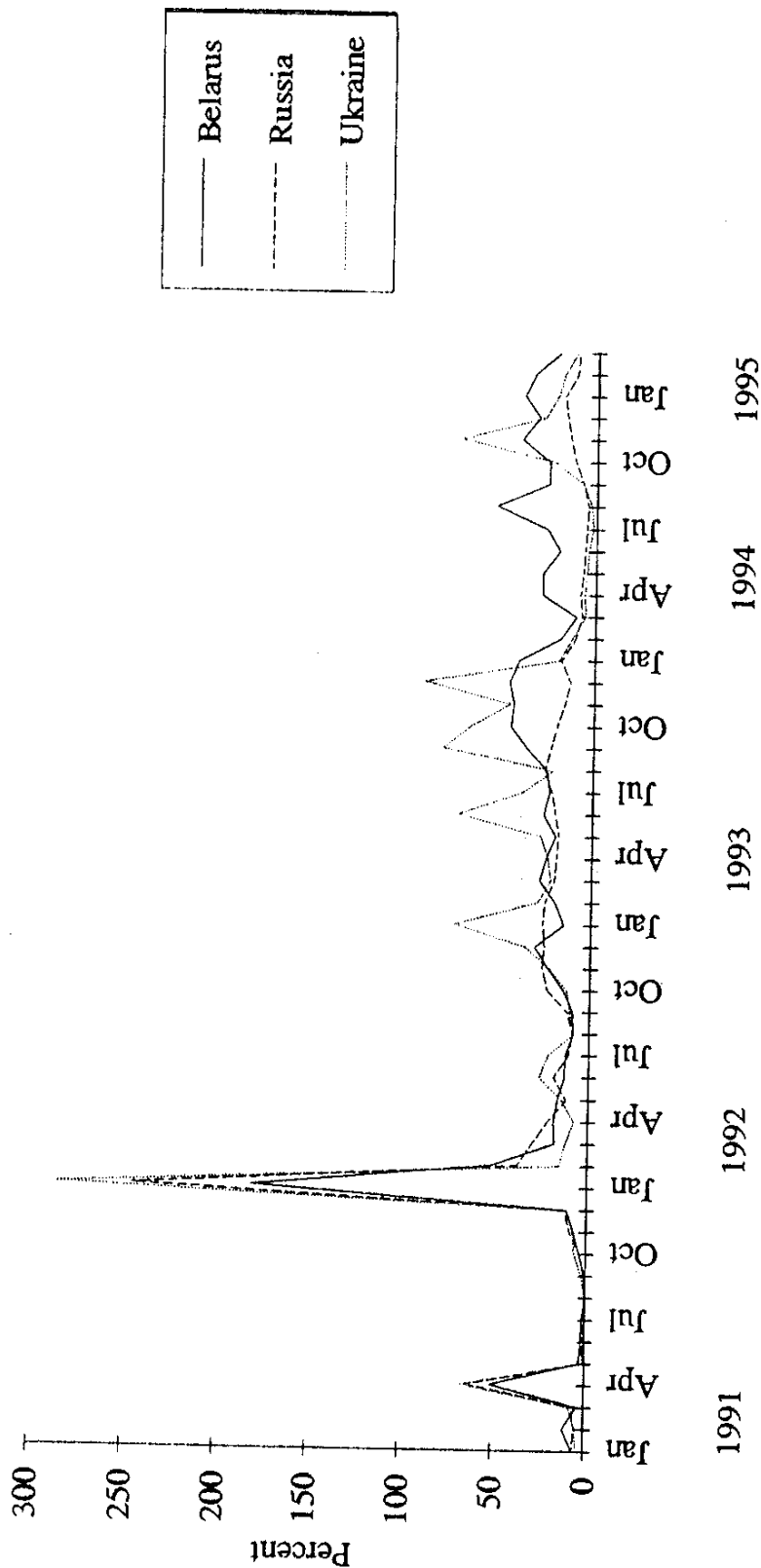
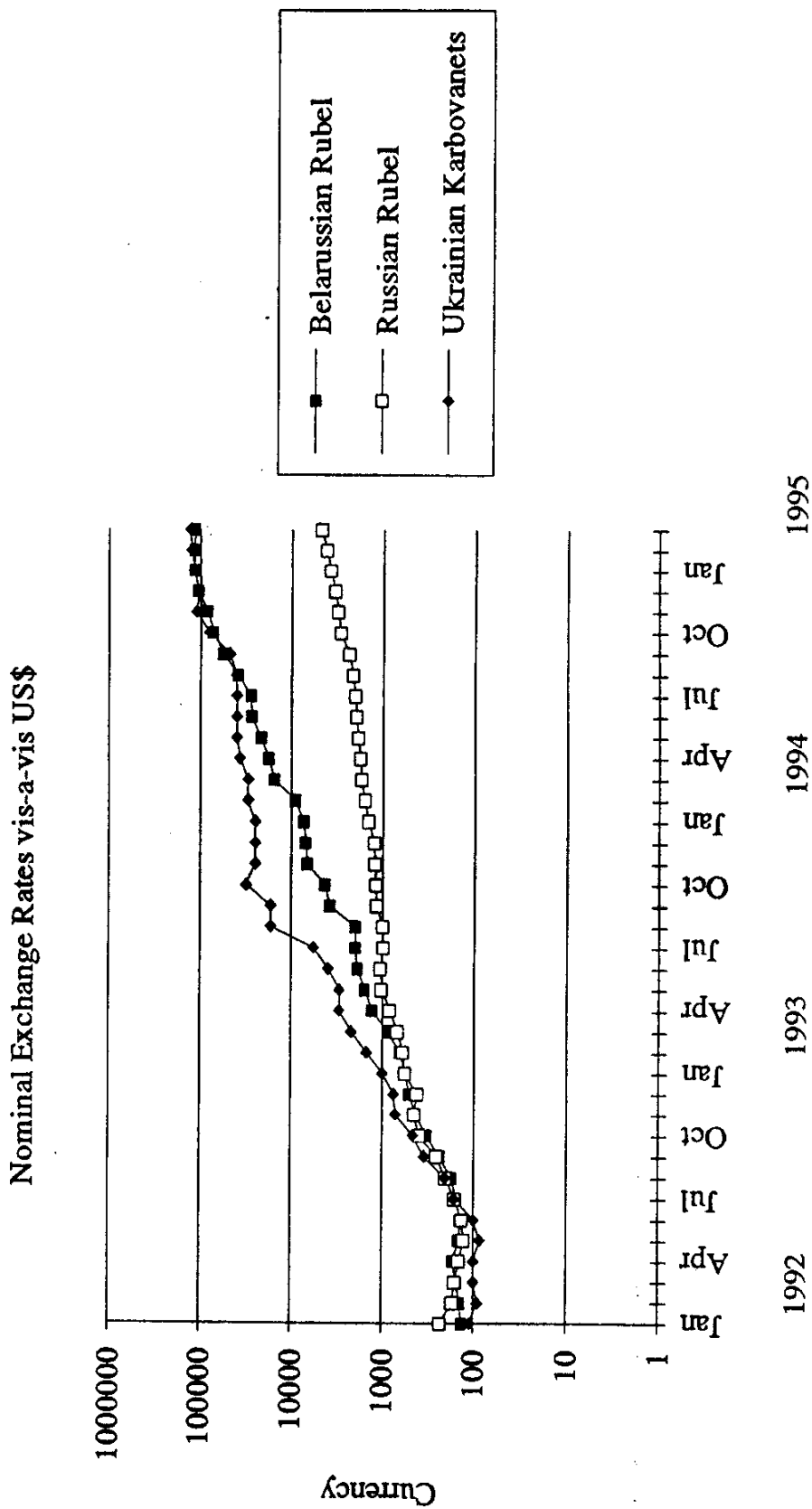


Chart 2



differentiation very quickly. This process started to accelerate in the second half of 1992, after the CBRF stopped the automatic monetary financing of inter-republican correspondent accounts and de facto separated CIS non-cash rubles from the Russian non-cash ruble.

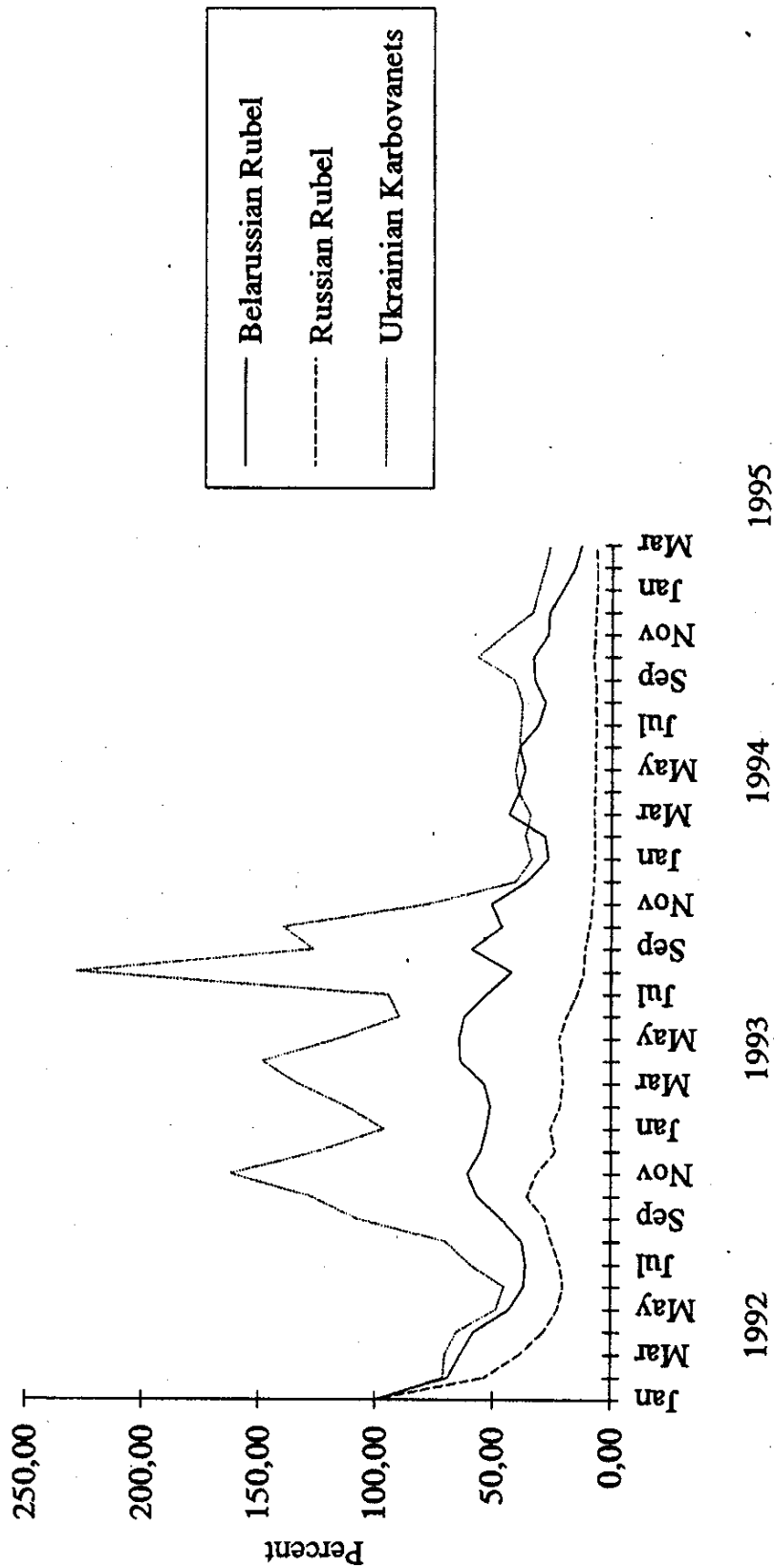
Table 13: Real Exchange Rates for Belarus, Russia, Ukraine in 1992- 1995 (first quarter) (January 1992=100)

		Belarus	Russia	Ukraine
1992	February	68,8	53,6	71,0
	March	63,6	38,8	70,3
	April	57,9	28,5	65,4
	May	43,3	22,6	48,6
	June	36,8	20,1	45,2
	July	36,1	21,6	59,6
	August	37,7	25,3	70,0
	September	46,6	27,9	108,1
	October	56,6	35,6	127,8
	November	60,8	31,7	162,2
	December	55,4	23,6	124,9
	1993	January	52,8	25,8
February		51,1	21,4	112,2
March		53,7	20,5	133,4
April		63,9	20,8	148,6
May		64,6	21,9	116,4
June		62,3	18,9	90,0
July		53,1	14,4	94,6
August		42,4	11,5	228,1
September		59,3	11,0	126,9
October		46,6	9,3	139,7
November		50,9	8,3	77,5
December		36,1	7,5	40,6
1994	January	26,9	7,3	34,1
	February	28,3	7,3	36,6
	March	43,6	7,3	34,6
	April	39,4	7,0	39,8
	May	36,9	6,9	41,1
	June	39,1	6,8	39,5
	July	31,4	6,7	38,7
	August	28,2	6,8	38,1
	September	32,9	7,0	41,5
	October	33,4	7,8	57,3
	November	27,4	7,2	45,9
	December	26,7	6,7	33,8
1995	January	21,1	6,4	31,4
	February	15,8	6,4	28,6
	March	13,0	6,6	26,5

Source: IMF data; Russian Economic Trends; Ukrainian Economic Trends, TACIS

Chart 3

Real Exchange Rates vis-a-vis the US\$ (Index January 1992=100)



The direction of differences in the cumulative rates of nominal depreciation of individual currencies²² generally reflects differences in their cumulative inflation records. During the period under analysis, the Russian ruble lost nominally 24 times less in relation to the US dollar than the Belarussian ruble and 27 times less than the Ukrainian karbovanets. However, if we analyze the quantitative relationship between the nominal depreciation rate and the inflation rate more carefully, we see substantial differences between individual currencies. They reflect the differences in the speed of real appreciation (see chart 3 and table 13) of individual currencies. Generally, all three currencies appreciated really in relation to the US dollar during the period January 1992-March 1995, which reflects the progress in eliminating monetary overhang, exchange rate unification, and some liberalization of foreign trade. The real appreciation of the Russian ruble has been the highest so far, due to the positive terms of trade shock (the reverse of the other two countries' experience) on the one hand and the most progress in macroeconomic stabilization of the three analyzed countries on the other. The Ukraine saw a smaller real appreciation, due to extremely unfavorable terms of trade changes and the relatively long duration of a very soft macroeconomic policy. Throughout most of 1993, the Ukraine recorded a real depreciation of the karbovanets in comparison with January 1992. This was the result of both high inflationary expectations and the reintroduction of multiple exchange rate practices in the second half of 1993.

3. Decline of GDP

A deep output decline has been a common phenomenon for all the transition economies independently of the transition strategy adopted and seems to be affected by a combination of various macroeconomic and microeconomic factors (see Dąbrowski, 1995; Holzmann, Gács, and Winckler, 1995).

Table 14: Real GDP percentage change in Belarus, Russia, and the Ukraine, 1990-1994

Country	1990	1991	1992	1993	1994	Cumulative record 1990-4
Belarus	1.9	-1.9	-9.6	-11.7	-21.5	-37.4
Russia	-3.0	-13.0	-19.0	-12.0	-15.0	-48.9
Ukraine	-3.6	-12.0	-17.0	-17.0	-23.0	-55.0

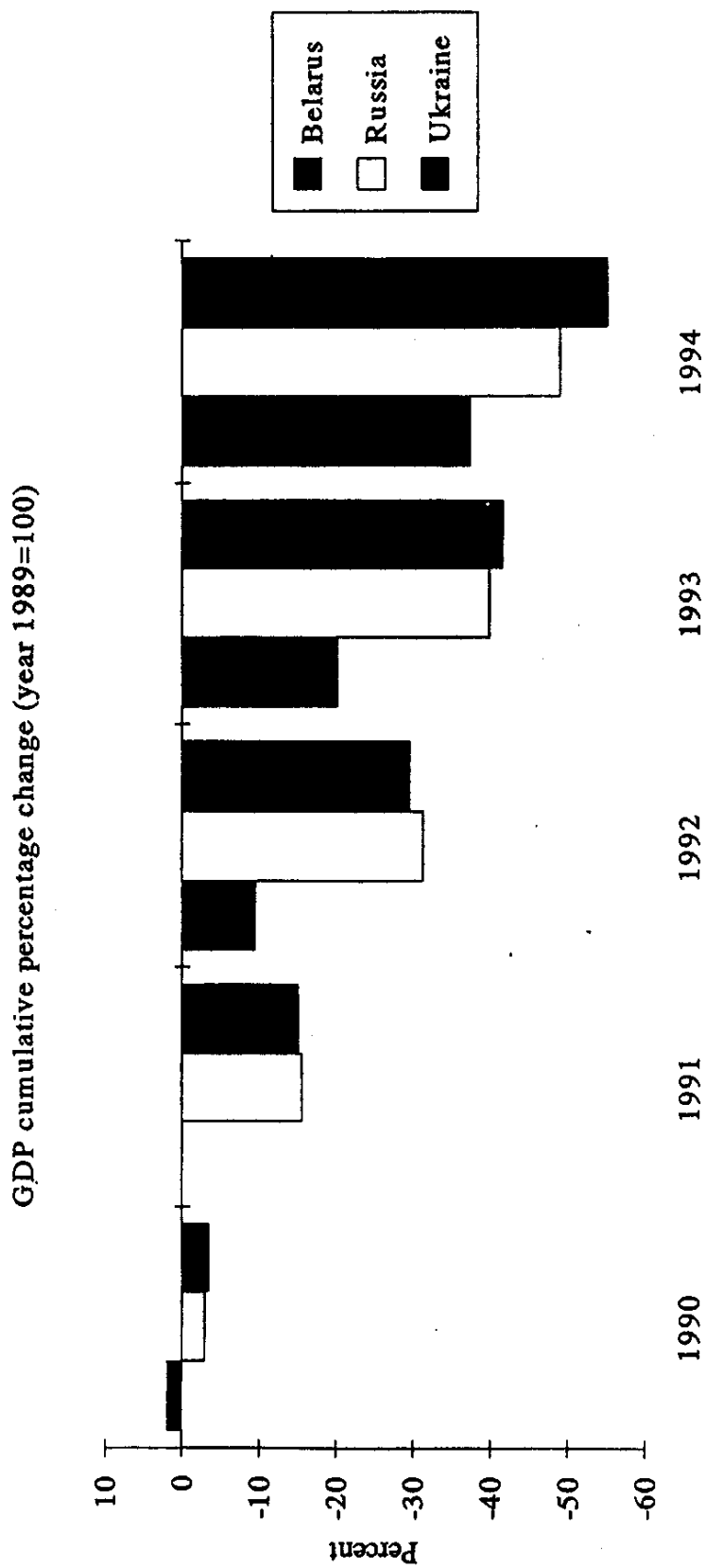
Source: IMF data; Independent Institute for Socio-Economic and Political Research in Minsk

Table 14 and chart 4 give us information about the size of the output decline in each country in every transition year and cumulatively for the entire period under analysis. Table 15 shows that the size of cumulative output decline was far bigger in the analyzed countries than in the Central European fast reformers and Estonia.²³

²² This comparison takes into consideration the redenomination of the Belarussian ruble which occurred in the second half of 1994 (10:1). All nominal figures concerning this currency exclude the effect of the redenomination.

²³ Both tables use different sources of information and cover different periods. Thus, they do not contain fully comparable data. However, this does not alter general picture.

Chart 4



Even taking into consideration the greater severity of external and structural shocks in the FSU countries than those experienced in Poland, Hungary, or Slovenia, this rough comparison gives strong evidence against slow and inconsistent reforms (see Dąbrowski, 1995).

Table 15: GDP growth (+) or decline (-) in selected transition economies

Country	1989	1990	1991	1992	1993	1994	Cumulative 1989-1994
Poland	+0.2	-11.5	-7.6	+2.6	+3.8	+4.5	-8.8
Czech Republic	+0.4	-3.0	-10.0	-5.0	-0.3	+1.5	-15.7
Slovakia	-1.0	-2.5	-11.2	-7.0	-4.1	+3.4	-21.0
Albania	+9.8	-10.0	-27.7	-9.7	+11.0	+8.0	-22.7
Estonia	+3.3	-8.1	-11.3	-19.3	-2.1	+5.9	-29.5
Latvia	+5.7	-3.4	-8.3	-33.8	-11.7	+4.1	-43.0
Hungary	+0.7	-3.5	-11.9	-4.5	-2.0	+1.0	-19.0
Slovenia	-3.6	-2.6	-9.3	-6.5	+1.0	+4.0	-16.4
Lithuania	+1.1	-6.9	-13.1	-37.7	-16.5	+4.7	-55.5

Source: The World Bank, IMF and PlanEcon data base

The attempt to maintain the output level at any price was the main factor in the adoption of very soft macroeconomic policies in Russia, the Ukraine, and Belarus. Ironically, this policy had the completely opposite effect: all three analyzed countries probably lost a great deal of output as a result of permanent high inflation. Very importantly, however, the fact that these heavy losses have already been incurred will not prevent further losses of output when stabilization programs are finally implemented.

We can also observe several important microeconomic factors influencing the scale of output decline in the analyzed countries. As we discussed in part I of this paper, the extent of inherited structural distortions was enormous. These distortions were enhanced by the collapse of interrepublican trade in 1992-1993. Some other structural factors such as demilitarization, the decreasing investment rate, changes in the structure of investment demand, rationalization of interregional links (especially in Russia), the elimination of forced substitution, and greater consumer freedom (resulting from the elimination of the rationing system and from privatization of part of collective consumption [e.g., housing]) have also seriously affected the activity of some sectors.

The Ukraine and Belarus underwent an external price shock as a result of the price adjustment of imported Russian energy (and other raw materials). In 1993-1994 the Ukrainian government wanted to isolate enterprises from this external price shock by maintaining explicit or implicit subsidies (this also occurred to some extent in Belarus). Of course, this policy led only to serious fiscal and balance of payments crises and to a physical shortage of critical inputs such as energy, which also

depressed the level of production. Russia was theoretically in a position to gain from terms of trade changes, but this has not happened so far. Probably this will occur later, when the liberalization and stabilization of the Russian economy are complete and the process of structural adjustment more advanced.

Finally, the collapse of the mobilizing role and incentives of the command system created a motivational vacuum which, because of delays in liberalization and privatization and the continuing presence of soft budget constraints, was not replaced very quickly by market forces and incentives. Widely held expectations of the massive bailout of state enterprises by the government tended to prevent adjustment by the SOEs to the new environment and stimulated an explosion of inter-enterprise debt (see Rostowski, 1993). The slow privatization process in the Ukraine and Belarus and the presence of hidden, *nomenklatura*-type ownership changes (see section II.3) also help to explain the low level of official economic activity.

Even if the greater extent of the output decline in the FSU²⁴ in comparison with CEE can be rationally explained, it is more difficult to interpret the differences within the analyzed group. The worst record, that of the Ukraine, can be explained both by the scale of structural shock and by the very populist macroeconomic policy carried out in 1991-1993. More surprising, however, is the relatively good record of Belarus in comparison with the Russian Federation. Perhaps the quality of statistical data, the size of the unregistered private sector (larger in Russia) and Belarus's relative delay in initiating the restructuring process can explain these differences.

The transition economy is a two-sector economy in the following sense: one part of the economy (mainly SOEs in heavy and military industries, large industrial construction, and sometimes also in socialized agriculture) is sharply declining because of the above mentioned factors, the second part (mainly the new private and privatized sector in trade and services) is growing dynamically. The decline of the first part, freeing resources such as labor, energy and other inputs, buildings and real estate, etc., enables the quick development of the second part. The speed of development of the "new economy" depends very much on the degree of real economic freedom (i.e., on the comprehensiveness and transparency of liberalization process), presence of hard budget constraints, stable macroeconomic environment (important for the investment climate), and progress in the privatization and restructuring of SOEs. All those factors have been missing so far in Ukraine and Belarus and only partly present in Russia. Developments in this sphere will determine the prospects of output recovery in the discussed countries.

²⁴ Of course, the scale of output decline is overestimated in all the transition economies for some obvious methodological reasons (see Bratkowski, 1993). The possibility that the output decline in FSU has been overestimated more than in CEE cannot be excluded.

Concluding Remarks: Political Determinants of Economic Transition

Both the similarities and differences between the three analyzed countries can be explained mainly by domestic political factors. A broader comparative analysis of the transition countries in CEE and the FSU may show a strong correlation between the extent of political changes and that of progress achieved in the area of economic transition (see e.g., Aslund, 1994a). Countries which have made the most progress in the economic transition are usually the ones that have been leaders in the democratization process. This is because sound democratization allows for the break-up of the political and economic domination of the former communist oligarchy (*nomenklatura*) and elimination of economic structures inherited from the communist systems (e.g., various types of branch organizations). Countries that have made only partial progress in democratization and political liberalization (most CIS countries and Rumania) have serious problems with real demonopolization and deconcentration of domestic market structures, external liberalization, removal of subsidies and hardening of budget constraints, avoiding the organized clearing of inter-enterprise arrears, implementing a real positive interest rate policy, implementing large-scale and transparent privatization, changing SOE managers, etc. The economic policy of these countries is dominated by the strong rent-seeking groups of special interests originating mainly from the old structure of the economy.

The above correlation is not surprising. The economic transition in former communist countries would not have begun if political liberalization and democratization had not occurred. All experiences with pre-transition reforms shows that they never reached certain critical points (such as the abandonment of the monopoly of state ownership) because the communist political regime would not allow this (even in its most liberal version such as in Hungary or Poland).

When the communist system finally collapsed at the end of 1980s, two factors determined the speed and consistency of economic transition to capitalism: the radicalism of political changes and the personal quality of the leadership of economic reform.

The importance of the first factor is connected both with the nature of any fundamental economic reform (not only in post-communist countries) and with the unclear economic preferences of the post-communist societies. Every serious economic policy reform must hurt many existing interests. The enormous agenda of post-communist economic transition makes this operation especially difficult. This means that the success of economic transition depends both on a strong political stimulation and on the weakening of the expected political resistance of the lobbies which could lose as a result of the changes. Both are possible only if the political transformation is deep enough. This was the case in Poland, Czecho-Slovakia (especially the Czech Republic), Hungary, and the Baltic states, where radical

political changes created a window of opportunity for radical economic transformation.²⁵

Radical political changes can also assist economic transition in another way. Because of the long break with capitalism (see part I), a significant part of post-communist societies approved *de facto* many aspects of the communist economic system such as fixed low prices, guaranteed employment, quite substantial social welfare programs, etc., even while being strongly politically opposed to the communist regime or not enjoying some other aspects of economic life in this system (e.g., market shortages, low quality of consumer goods). Thus most or even all the transition societies were not prepared to choose *expressis verbis* the tough pro-market and anti-inflationary transition strategy, even if they generally accepted capitalism and a Western style of living. The only possible way to gain temporary democratic support for carrying out difficult economic reforms was to utilize the general political credit vested in the new political elites who were breaking with communism and (in many cases) maintaining newly achieved national independence.

The quality of the new elites is the second important factor which must be taken into consideration. The political opportunity to initiate radical reform is a necessary condition but not a sufficient one. The period of extraordinary politics (to use Balcerowicz's terminology) is usually very short and is replaced by the period of "ordinary" politics when the special interest groups activate themselves again. If the economic transition is slow and inconsistent it can create special arbitrage opportunities for intensive rent-seeking. Consequently, interest groups built around these opportunities (e.g., government bureaucrats distributing export quotas and licences, managers of *kolkhozes* and *sovkhoses* receiving heavy subsidized credits) will struggle strongly against real liberalization and macroeconomic stabilization (see Krueger, 1990; Havrylyshyn, Miller, and Perraudin, 1994).

The short transition history gives us examples of lost chances - Lithuania under the Sajudis government (1991-1992), the Ukraine (1991-1993), and partly Russia (see below). Once lost, a political window of opportunity for substantial economic reform can come again only after some period of time. The negative social and political effects of economic mismanagement usually educate both society and political elites, changing their attitude toward economic policy priorities. However, such an education is very painful and sometimes lasts many years.

Moving from a general discussion to the countries analyzed in this paper, one finds that at the end of 1991 the Ukraine could have been in the best political position to start a rapid and consistent economic reform. This was due to the great social support for Ukrainian independence, which probably could have been quite easily converted into the readiness to bear the necessary economic and economic sacrifices. The Estonian and Latvian experiences (both countries started from a similar economic and political situation in the end of 1991) provide indirect support for this hypothesis. Unfortunately, the Ukrainian political elites lost this chance completely in

²⁵ L. Balcerowicz (1994) calls this specific window of opportunity opening after the collapse of communism the period of "extraordinary politics."

the first three years of independence. Only after the presidential election in July 1994 did the situation begin to change in a positive way. The new president Leonid Kuchma have seemed to learn from his own negative experience (as Prime Minister from October 1992 to October 1993) as well as that of former president Kravchuk. He decided to use the political credit gained during the election to implement a comprehensive package of economic reform.

Russia also had a political window of opportunity for radical economic reform after the collapse of the Yanaev coup d'état in August 1991. This occasion was used by President Boris Yeltsin to create a reform-oriented government in early November 1991 with Deputy Prime Minister Egor Gaidar as leader of the economic policy team. However, the period of extraordinary politics was relatively short - the rising political confrontation between President Yeltsin and Supreme Soviet began in the spring of 1992. Additionally, the Gaidar team made some conceptual and implementation mistakes, failing to make optimal use of the existing political opportunity (Dąbrowski et al., 1993; Dąbrowski and Rostowski, 1995). The next window of opportunity, after the April 1993 referendum, was lost by Boris Yeltsin himself, who could not use his political victory for reconstruction of the government and speeding up the reform process. Another period of extraordinary politics, after the collapse of the October 1993 communist-fascist uprising in Moscow, was too short to make substantial progress in stabilization and liberalization. After the December 1993 parliamentary elections, Russia was forced to continue its economic transition in the more complicated political atmosphere (see Aslund, 1994b).

Belarus never enjoyed a real period of extraordinary politics because of the lack of a radical break with a communist past. The collapse of the August 1991 coup d'état brought only minor changes on the Belarussian political scene. The democratic and pro-independence political movement in this republic was always very weak and the political scene strongly dominated by the political interest groups connected with socialized agriculture and large SOEs. This situation resulted in the election of President Alexander Lukashenko in July 1994 and results of the May 1995 referendum and parliamentary election.

Comparing the Ukraine and Belarus, one notices the great importance of the independence factor. The strong presence of this factor in the Ukraine finally mobilized the political elites to struggle with the deep economic crisis which began in 1994 to threaten the unity and independence of the Ukrainian state. In contrast, Belarussian political leaders (Prime Minister Vyacheslav Kebich until July 1993 and President Lukashenko thereafter) have tried to realize the idea of monetary and economic union with Russia as a substitute for real economic transition.

Analyzing the professional quality of political elites and government administration, one must conclude that Russia has an advantage in comparison with its two neighbors. Gaidar, Fedorov, and Chubais were able to organize a quite impressive team of young market-oriented economists working on transition policy (many of them continuing work in the government after the first two left it), whereas the Ukraine and Belarus have had very few individual reformists in their governments and central banks. This is also true of the broader base of specialists,

academic economists (who are usually the natural base for recruitment to reform governments), journalists, etc.²⁶

Finally, progress in reforming the constitution and electoral laws plays an important role. Russia, after the dramatic events of September and October 1993, finally has a constitution that separates the legislative and executive branches of government, giving the latter a great deal of power (probably even too much) in the current management of the economy and fully subordinating the government to the president. Russia also has a mixed election law, with half of the Duma elected according to a majoritarian scheme and half according to a proportional scheme with a 5% minimum. This second component stimulates the building of a system of national parties (though this process is still in a rather early stage) and allows the Duma to have more professional politicians as its members (and less "red" managers).

President Kuchma has only just reached (June 1995) a constitutional agreement with the Ukrainian parliament allowing him to nominate the cabinet and separating the executive and legislative branches of government. However, this agreement is valid for one year only and during this period should be replaced by a new constitution. The Ukrainian parliament is still elected on the basis of a majoritarian scheme with a rather weak position for political parties and a large number of "independent" members, mainly local SOE and *kolkhoz* managers. Until the recent constitutional agreement, it also had rights to interfere in almost everything, which is a typical characteristic of the traditional Soviet-type parliamentary system.²⁷

Belarus also possesses such a system (together with a majoritarian election law). President Lukashenko is currently (April-June 1995) struggling to increase his power at the expense of the parliament, but the results of this conflict are very unclear so far. Moreover, Lukashenko seems to lack a clear vision of constitutional order in his country (as well as of economic reform), and this conflict actually concerns his personal power.

²⁶ Russia also received far more technical assistance from international institutions and Western governments than its neighbors. The inflow of foreign experts to the Ukraine really started only in the second half of 1994.

²⁷ Of course, before the partly free elections to the republican Supreme Soviets in 1990, the supremacy of parliament over the executive branch was purely formal. All strategic decisions were made by the Central Committee of the CPSU and headquarters of the republican Communist parties.

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