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Whither Russia? A Review of Andrei Shleifer's *A Normal Country*

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In this review, the author reflects on the heated debates around views about Russia's postcommunist transition expressed in essays collected in new Andrei Shleifer's book, A Normal Country: Russia after Communism *(Harvard University Press, 2005), which were initially published at different times during transition. She focuses on the three questions that have been in the center of the debate among academics and policymakers: What should the sequencing and the speed of reforms be? Should a country have political centralization for fiscal decentralization to be efficient? Is Russia normal? The author argues that Russia's most recent history provides convincing evidence in support of the logic of political and economic transformation as it was understood by Shleifer as early as the beginning of the 1990s.*

1. *Introduction*

Transition from central planning to market is one of the most important events in modern economic history. Apart from the fact that transition changed the lives of more than a billion people in almost thirty countries, it had and continues to have an important effect on the economics profession. Transition provides academic economists with an unprecedented opportunity to put many propositions of economic theory to test. Many important lessons are being drawn from transition experiences of different countries; the most important of them are about the significance and limitations of economic analysis.

Russia's experience of the last fifteen years symbolizes all the challenges and opportunities of the transition process. Russia started as the quintessential planning economy. Yet, from the very start and up to this date, Russia's transition has been full of controversy. Both inside and outside of Russia, the views on whether Russia's transition is a success or a failure changed virtually every couple of years. The overwhelming voter support for Boris Yeltsin in 1991–92 was lost already in 1993. The rosy expectations of the "coming Russian boom" in 1996–97 were followed by the "who lost Russia?" debate of 1998–99. Russia was "rediscovered" in 2000–2003 when the expectations were that it joins China, India, and Brazil to become one of the world's leading economic powers and to take the place of Britain, Germany, France, and Italy in the G-7 group by 2050. Despite the continued strong growth, the mood swung back in 2004: many interpret the current situation as a reversal of both economic and democratic transitions.

It is often argued that to judge whether the transition has been a success, one has to

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go back to the original goals and expectations in the beginning of 1990s. This certainly is a useful exercise, but by no means sufficient. The first president of Russia, Boris Yeltsin, believed strongly that his historical mission was to make sure that Russia could never go back to communism and totalitarianism. On the economic front, he aimed at building a prosperous market economy. By the end of his second term, it was virtually a conventional wisdom that he overwhelmingly succeeded in his first task but failed the second one. Several years down the road, it is again almost obvious that the opposite is true: Russia is prospering economically but is becoming increasingly authoritarian.

In a retrospect, it is clear that many of the extreme positions taken along the way are best explained by representativeness heuristic—an anomaly imbedded in the nature of human judgment that entails attributing special features of a mere realization from a stochastic process to the characteristics of the general population. The swings in understanding of Russian transition make it evident that the students of economics, and especially those of political economics, must take a longer-term view to understand the fundamental drivers of reforms. For intellectual honesty's sake, we should also try to revisit our prior views and confront our theories with recent evidence. Andrei Shleifer's excellent book, *A Normal Country*, presents a unique opportunity to do so.

2. *The Book*

The book brings together a set of academic articles written by Shleifer and his coauthors about the most important challenges that Russia's reformers faced during the first decade of transition. The articles that became book chapters were written and originally published mostly in the 1990s at the time when the actual policy choices were faced by policymakers. Step by step, *A Normal Country* analyzes the major institutional changes in Russia starting from the command planning system to the point where it ended up after a decade and a half of transition. The last chapter in the book (by Shleifer and Daniel Treisman) presents the authors' judgment about where this point might be; the conclusion of this chapter is stated in the book's title.

A Normal Country is a courageous and largely successful attempt to take a longer-term view on the most important issues of transition. It allows having an honest look back and assessing the ideas proposed by Shleifer and his collaborators at different times during Russia's transition. Since many of these ideas were at the heart of both academic and policy debates over the course of transition, the book gives an exciting opportunity both to confront them with the outcomes that we observe ten years down the road and also to check them for internal consistency.

The book chapters focus on different aspects of the institution building during Russia's transition; yet, there is a broad overriding theme of the book: depoliticization of firms as the major key element of transition. The book addresses the issues of why depoliticization is important; which reforms are needed to achieve it; what are the major challenges and the strategy for their implementation in the face of political and economic constraints; and, finally, how far Russia's transition has gone in securing depoliticization. Shleifer argues that state intervention into economic life in all of its forms, ranging from the system of command planning and state ownership of firms to discretionary regulation and subsidization of private firms, is fated to create severe inefficiencies and result in corruption, unofficial economy, and suppression of economic growth. The main reason for this is that politicians systematically pursue objectives other than economic efficiency. First, they reallocate resources toward securing their own political power at expense of economic efficiency. And second, they are dependent on concentrated special interests. Since at the start of transition the governments had unconstrained influence on all aspects of economic life, the main goal of reforms during transition had to be to establish institutions that put effective constraints on government's intervention in firms and markets.[1] *A Normal Country* applies this general theme to the specifics of Russia's reforms. It analyzes which reforms were needed to secure constraints on Russia's state and why.

In this review, I want to reflect on the heated debates around many of the views about Russia's postcommunist transition expressed in this book. In particular, I focus on the three issues discussed in the book that have been in the center of the debate both among the academic economists studying Russia and the policymakers working in and with Russia. In what follows, I will argue that Russia's most recent history (that took place after the majority of the essays in the book were written) provides convincing evidence in support of the political and economic logic of institutional transformation as it was understood by Shleifer in the early 1990s. In addition, the book proves to be a very useful tool for understanding Russia's prospects as of today.

3. *The First Debate: The Logic of Institutional Transformation*

One of the major debates of the transition literature throughout the 1990s was on sequencing and the speed of reforms. In particular, one of the central questions in this debate was whether priority should be given to rapid privatization as Shleifer and his coauthors advocated or, in contrast, to establishing competition, rule of law, social and organizational capital, and other market-supporting institutions prior to privatizing (see, for instance, Joseph E. Stiglitz 2000, 2002).

Gérard Roland (1994) introduced a useful framework to analyze alternative reform strategies from the political economy perspective. He distinguished between ex ante political constraints (reflecting the strength of political resistance to reforms) and ex post political constraints (reflecting the danger of policy reversals after implementation of reforms and realization of their outcome). It is useful to revisit this debate using Roland's framework.

3.1 *Ex Ante Political Constraints*

Russia went through many of the key institutional reforms in the first five to seven years of transition. In particular, big bang liberalization and privatization of firms were largely completed by 1995. Yet, Russia's record in such areas as establishing the rule of law and deregulation was extremely poor. Throughout most of 1990s, Russia's GDP was shrinking, living standards deteriorating, and unofficial economy rising. Motivated by the rising criminalization and by poor macroeconomic performance during the first stages of Russia's transition, many scholars heavily criticized Russia's reformers and their advisors, including Shleifer, for "market fundamentalism," i.e., disregard of market-supporting institutions and "naked faith" in the invisible hand of the market.[2]

To be fair, it is worth noting that accusations of "market fundamentalism" seem to ignore many policies actually implemented during the first years of Russia's transition. Most of what reformers were doing was creating institutional foundations of market economy from scratch in contrast to the claims of their critics. A few examples from a much longer list are the establishment of an independent central bank, securities and

[1] The general theoretical arguments behind this theme are featured in another book by Shleifer written jointly with Robert W. Vishny, *The Grabbing Hand: Government Pathologies and Their Cures*, published by Harvard University Press in 1998.

[2] See, for instance, Stiglitz (2002) and Grigory Yavlinsky and Serguey Braguinsky (1994). Chapter 5 of *A Normal Country* includes Shleifer's response to the work of Yavlinsky and Braguinsky.

exchange commission, tax system, customs, constitutional court, consumer rights law and consumer rights organizations, and bankruptcy law.[3] The problem with many of these institutions was not that they were missing but that they failed to function properly; for example, many market-supporting laws were not enforced (Katharina Pistor, Martin Raiser, and Stanislaw Gelfer 2000 and Pistor and Chenggang Xu 2004). It is true, however, that several key reforms, including those from the "Washington consensus" list (John Williamson 1990), have not even been attempted at that time, e.g., deregulation and privatization of land.

Irrespective of whether the architects of Russia's reforms—Egor Gaidar and Anatoly Chubais—were "market fundamentalists" and of whether they pursued "Bolshevik strategies" as Stiglitz (2002) puts it, *A Normal Country* vividly demonstrates that the criticism of ignoring the importance of market-supporting institutions surely did not apply to Shleifer who, at that time, served as an advisor to Russia's government. Almost every single chapter in the book focuses on the challenges of creating market supporting institutions and, particularly, rule of law. Seven out of eight chapters in the book that are devoted to specific reforms—all but one published before 1998—speak of the importance of such institutional reforms for the success of transition as legal and judicial reform, establishing sound competition policy, deregulation of small business, tax reform, reform of fiscal federalism, etc. Even the chapters that were written on the very eve of Russia's privatization, e.g., chapter 3 of the book "Privatizing Russia" originally published in 1993, go far beyond the "Washington Consensus" and argue that, without corporate governance, antitrust, and functioning capital markets, privatization can not achieve its main goal—depoliticization.

So why, despite so much attention devoted specifically to institutional reforms, did many of them not materialize during the 1990s and why did many materialize only on paper? Shleifer's answer is that the logic of institutional transformation dictates that functioning market-supporting institutions could not be established before the emergence of a demand for them, namely, the emergence of a class of economic agents who are supposed to play by the rules set up by these institutions. The "Privatizing Russia" chapter of *A Normal Country* argues that a precondition for creating this demand was formation of markets and private property (see also Maxim Boycko, Shleifer, and Vishny 1995). One of the main goals of privatizing fast was political: rapid privatization according to Shleifer and his coauthors was needed to create a political constituency that supports further reforms. The flip side of this argument is that ex ante political constraints were too strong: special interests against reforms (e.g., bureaucrats in industrial ministries, managers of large state-owned enterprises (SOEs) often called "red directors," regional governors, and SOE workers) were politically too powerful at that time and reformers were unable to co-opt or crush these interests.[4] For example, resistance to a new Land Code from the Communist wing of Russia's parliament—a faction with broad political base at the beginning of transition—was simply insuperable. Whether this political equilibrium was sustained or it had changed over the course of transition is an important test of Shleifer's thesis.

For the first eight years of Russia's transition, not much political pressure for institutional

[3] Egor Gaidar—the Acting Prime Minister of Russia (1991–92)—made this point in his address to the GDN's Seventh Annual Global Development Conference in St. Petersburg in January 2006.

[4] Another brilliant book by Shleifer written jointly with Treisman, *Without a Map: Political Tactics and Economic Reform in Russia* (2000), shows that reformers' policy choice set, indeed, was substantially constrained by the political equilibrium in the Yeltsin's era.

reform was observed. At that stage, transition scholars realized that resulting from privatization (relatively) high wealth concentration may lead to subversion of government policies and institutions by the rich.[5] For example, Konstantin Sonin (2003) and Glaeser, Scheinkman, and Shleifer (2003) built insightful models showing that the rich (e.g., Russia's oligarchs) may block institutional reforms, such as establishing rule of law, because low property rights protection allows the rich and politically powerful to expropriate less powerful agents.

Nonetheless, many of the market-supporting reforms and other institutional changes that Shleifer argued for back in the 1990s did materialize later on. This happened between 2000 and 2003—long after the relevant chapters of *A Normal Country* were written. During the first Putin's term in power, Russia's government accomplished deregulation of small business, a drastic tax reform, a more transparent revenue sharing rule between the federal center and the regions, and adoption of the new Land Code that instituted private property for land. Importantly, most of these reforms have been lobbied for by private-sector organizations, and most of all by the "oligarchs' trade union" RSPP (Russian Union of Industrialists and Entrepreneurs). Substantial microeconomic adjustments followed shortly after these measures have taken effect. For example, a regular survey of a representative sample of two thousand small businesses conducted by the Center for Economic and Financial Research in Moscow (CEFIR 2004 and 2005) shows both the substantial improvement in regulatory burden for small firms and its positive effects on business growth. In addition, since 2000, scholars have observed very substantial improvements in corporate governance and transparency in large and medium-size firms in Russia (Guriev, Olga Lazareva, Andrei Rachinsky, and Sergei Tsoukhlo 2003 and Peter Boone and Denis Rodionov 2002).

These recent developments, in my view, provide convincing evidence in favor of Shleifer's original view of the logic of institutional transformation even if the change has taken a lot longer than reformers expected. Completion of the first wave of liberalization in 1992–96 and subsequent (partly lawless) consolidation of ownership in the second half of the 1990s led to the formation of a class of large private majority owners as an important political force that pushed for further reforms. These individuals acquired a stake in continuation of institutional reforms since they became interested in attracting outside finance and protecting their property rights. One can illustrate this logic by the mechanism behind recent changes in corporate governance. Before ownership consolidation in the 1990s, asset stripping was the main activity of a majority of top corporate executives, so-called "red directors." At the turn of the century, the initial process of consolidation was completed and the majority owners gained control over their enterprises. Criminal gangs who previously provided protection to asset stripping out of state-owned and employee-owned firms in the early stages of transition were forced out of the market. It is now quite clear that decriminalization of large business occurred only because racketeers faced controlling owners who were credibly committed to legalize their business and to fight for protection of their own property. This sharply contrasts with incentives of red directors who were interested in tunneling assets out of firms in which they de facto had full control but no cash-flow rights. The winning fight of large outside corporate owners over the criminal gangs jointly with deregulation and tax reform turned the growth of the unofficial economy around as many activities were brought to the official sector (Nina Glavatskaya and Svetlana Serianova 2003).

[5] See, for instance, Joel S. Hellman 1998; Sonin 2003; Edward Glaeser, Jose Scheinkman, and Shleifer 2003; Karla Hoff and Stiglitz 2004; and Irina Slinko, Evgeny Yakovlev, and Ekaterina V. Zhuravskaya 2005.

These events very closely follow Shleifer's predictions made in the outset of privatization. It is quite evident that the institutional changes of 1999–2003 were impossible without the demand for market-supporting institutions coming from the newly emerged private owners. Interestingly, even the largest politically powerful oligarchs (featured in Sonin 2003 and Glaeser, Scheinkman, and Shleifer 2003) started to open up and improve corporate governance and transparency of their firms as the well-known story of Yukos before 2003 demonstrates (Guriev and Rachinsky 2005).

3.2 *Ex Post Political Constraints*

The growing demand for secured private property that is finally coming from Russia's business elite is not the whole story, however. There is also an emerging demand from bureaucrats to regain control over privatized assets in the last couple of years. This demand is based on the popular sentiment that private owners gained their property illegally.

An important implication of privatization under the initial conditions of high corruption and generally poor institutional environment is that property rights of the newly emerged owners may be deemed illegitimate by the general population (Roland 1994; Guriev and William L. Megginson 2006). In this case, voters would happily endorse expropriation of the newly emerged private owners. This creates a serious danger of a reversal of transition. Politicians may use public sentiment to gain political control over firms either through renationalization of assets or through increasing state's bargaining power vis-à-vis privately owned firms by using the politically credible threat of their expropriation. In both cases, the resulting fragility of property rights severely undermines incentives of the newly emerged private owners; and the main goal of transition—depoliticization—is jeopardized.

This scenario is perfectly consistent with the latest developments in Russia. Russian voters believe that individuals who now have control over formerly state-owned firms appropriated their assets dishonestly. For example, a poll conducted in the summer of 2003 by ROMIR Monitoring (an independent polling firm in Russia), showed that 88 percent of the Russian population think that all large fortunes were amassed in an illegal way, 77 percent said that privatization results should be partially or fully reconsidered, and 57 percent agreed that the government should launch criminal investigations against the wealthy (*Vedomosti* 2003). The public holds particularly strong adverse feelings toward those businessmen who organized and (not surprisingly) won "loans-for-shares" auctions of 1996.

This perceived illegitimacy of property rights gave the foundation for a turn in Putin's economic policy starting 2004. The two distinguishing features of this new policy seem to be (1) a creeping renationalization and (2) an increase in harassment by tax collection agencies. Renationalization started with a showcase when the Yukos controlling owner, Michail Khodorkovsky, was expropriated and sentenced for eight years in prison on tax evasion charges with a full support from the median voter. Yukos's main asset was passed on to state-owned oil holding Rosneft. Since then, the largest state-controlled corporations acquired a number of important assets from Russia's oligarchs.[6] Since oligarchic ownership has been shown to be more efficient than state ownership

[6] The largest deals included the following: Gazprom got control over Abramovitch's Sibneft and Bendukidze's OMZ; Rosneft acquired Potanin's Verkhnechonskneftegaz; RAO United Energy Systems bought Potanin's Siloviye Mashini; Vneshtorgbank got hold of PromStroyBank; and Rosoboronexport jointly with Vneshtorgbank took over AvtoVAZ. All analysts expect the trend to continue. For example, Potanin's main asset—Norilsk Nickel—is expected to be sold to the state-owned diamond monopoly Alrosa (see, for instance, an interview with Al Breach, a co-head of research at Brunswick UBS http://www.aton.ru/en/news/publication.asp?id=108269&page=1&order=pubdate&type=publication).

(Guriev and Rachinsky 2005), these deals substantially diminish economic efficiency.

There is little doubt that all assets that were privatized in the notoriously corrupt "loans-for-shares" deals in 1996 will be renationalized in one way or another. The reason for it is that, given the attitude of the general population, Putin cannot commit not to expropriate even those oligarchs who fully support him. Thus, oligarchs loyal to the Kremlin are forced to sell their assets to state-owned companies at below market prices.[7] Whether the policy reversal will go beyond "loans-for-shares" depends on the strength of the public sentiment about illegitimacy of mass privatization and of the initial process of ownership consolidation. Particularly, the worry is that renationalization reaches firms in such industries as ferrous metallurgy and telecommunications, which would be a true sign of turning back. These firms were not subject to "loans-for-shares" privatization. But, if public dislike of privatization process extends beyond "loans-for-shares," it will not be easy for Putin's cronies to resist temptation to get control over these assets as well.

In addition to creeping renationalization, in 2004 and 2005, tax inspectors substantially tightened screws. According to Anatoly Chubais, the father of Russia's privatization and the CEO of RAO UES, about 90 percent of businesspeople suddenly got problems with tax collection agencies. In 2004, the tax ministry increased its tax claim on Russia's private companies (excluding the Yukos group) by eight billion dollars, which is eleven times the sum of 2003. According to the data from the first half of 2005, the additional tax claim will be even higher in 2005 (Vedomosti 2005).

Looking back, we see that this political equilibrium fifteen years down the road has been recognized as a possible outcome by the early transition literature. Scholars on both sides of the debate—those who advocated a gradual approach and those who argued for a big bang strategy—have written about it. For example, Roland (1994) writes that, if a privatization program is advertised as egalitarian but produces high concentration of wealth in the hands of a small number of people, there is a danger of a backlash due to the political demand for redistribution. Shleifer and his coauthors also warned against ex post political costs of "spontaneous privatization." They showed that reformers rejected a few privatization options precisely because "turning thousands of managers into multi-millionaires overnight would incite popular outrage" (Boycko, Shleifer, and Vishny 1995, pp. 60–61). Yet, it is evident that neither the designers of Russia's reforms nor their opponents seriously considered the possibility of a reversal ten years after privatization (rather than right after it), particularly at a time when real incomes of the poor are growing. A careful reading of the privatization manifesto *Privatizing Russia* (Boycko, Shleifer, and Vishny 1995) shows that the primary concern of reformers was the contemporary political equilibrium. Pushing reforms forward, indeed, required a lot of effort in overcoming politically strong anti-reform interests. Advocates of a gradualist approach were thinking of ex post costs, but they mainly were concerned with political costs of potential massive layoffs from privatized enterprises rather than legitimacy of private property (Mathias Dewatripont and Roland 1992; Roland 1994).

[7] Even when the reported sale is at the market price, rumors are that a substantial share of the overall price actually is used as a kickback. (These rumors, for instance, have appeared on the radio "Echo Moscow," see the transcript of a program by a prominent Russian journalist Yulia Latynina on March 11, 2006, http://www.echo.msk.ru/programs/code/42280/). If these rumors are true, billions of dollars end up in the pockets of the top bureaucrats as a result of these deals. It is important to mention that apart from rumors, there is no evidence of this what so ever. I could not find a citation about this in the Russian press as well. This, of course, could mean two things: one is that I am wrong and it actually is not true; but the other, more plausible to me, is that the media is controlled. The basic economics argument is straightforward: since the threat point is the Yukos-like complete expropriation, the equilibrium outcome cannot provide the oligarchs with a full market value of their assets.

Shleifer's opponents are quite correct when they point to absence of rule of law as the reason for the emergence of this bad political equilibrium. The non-cash insider privatization de facto transformed itself into "spontaneous privatization." For example, managers used transfer pricing to divert assets to private companies; they also intentionally accumulated high wage arrears to employees and, then, forced employees to sell their shares at low prices to the management. In addition, the outright corruption of "loans-for-shares" disproportionately shaped the public perceptions of the whole privatization process. Thus, it is important to revisit the debate about the logic of institutional transformation and to understand whether various other feasible options in the outset of Russia's privatization would have changed the ex post illegitimacy of property rights. My view is that, among all the feasible options, none could have solved the legitimacy problem Russia is facing now. In fact, most alternative solutions proposed by Shleifer's opponents would have only exacerbated it. I would like to look at the proposed alternatives for Russia's privatization from only one angle—the extent to which they are likely to have resulted in lower fragility of property rights.[8] One can identify three distinct views on what Russia's privatization strategy should have been: (1) Russia should have delayed privatization following the Chinese example (i.e., Peter Murrell 1992 and Stiglitz 2002); (2) Russia should have chosen other methods of privatizing but voucher privatization, e.g., case-by-case cash sales preferably to foreigners (i.e., John Nellis 1999); and (3) non-cash voucher privatization was the best among all politically feasible options (the view of Shleifer and his coauthors).

It is absolutely clear that, in a corrupt environment as Russia was in the 1990s (and, by the way, remains such), continued state ownership would have lead to full-fledged spontaneous privatization. The reason for this is the weakness of Russian state's enforcement power and inherent inefficiency of bureaucracy. The power of Russia's central government and its ability for law enforcement had deteriorated even before the collapse of the Soviet Union. (The second chapter of *A Normal Country* demonstrates this using the example of partial reforms attempted by Gorbachev in the late 1980s). The reform strategy that worked so well in China because of efficient bureaucracy and effective enforcement would have definitely failed in Russia. Therefore, even abstracting from all the efficiency considerations of leaving companies in state hands, it would not have resulted in a better attitude of the median voter toward economic reforms in general and legitimacy of property rights, in particular.

As far as the case-by-case privatization is concerned, Shleifer and Treisman (2000) correctly point out that Russia did experiment with this method of privatization. "Loans-for-shares" program "is nothing but case-by-case privatization as it actually happened" (p. 35). Loans-for-shares deals are rightfully perceived by the public as by far the most corrupt part of Russia's privatization. Judging by the loans-for-shares experience, case-by-case privatization in the environment of widespread corruption would have resulted in even lower legitimacy of private property rights compared to non-cash mass privatization. Indeed, open, fair, and transparent auctions were just not a feasible option for Russia at that time. Two very recent examples of auctions—one of privatization, the other of renationalization —show that things have not changed for the better on this front: corruption and collusion in the case-by-case auctions is as standard in Putin's Russia as it was in Yeltsin's. One example is Yuganskneftegas auction of

[8] In the third chapter of *A Normal Country,* as well as in *Privatizing Russia* (1995), Boycko, Shlefer, and Vishny carefully assess political feasibility of various privatization options for Russia. In the second chapter of *Without a Map* (2000), Shleifer and Treisman analyze possible consequences of these different options for continuation of reforms and for restructuring of Russia's industry.

2004—the climax of the Yukos affair—in which the state used a dummy "Baikal Finance Group" to transfer the asset to Rosneft in an extremely shady way (*New York Times* 2004 and 2005). Another example is Slavneft privatization auction. In 2002, this large state-owned oil asset was sold at a price slightly above the reserve price while competing bids (including a very competitive bid from a Chinese company) were excluded on technical grounds (*Financial Times* 2002).

Evidence shows that privatization to foreigners is by far the best option both for economic efficiency and political stability (Megginson and Jeffrey M. Netter 2001). Auctions to foreigners reduce the probability of corruption and collusion of bidders and, therefore, increase privatization legitimacy. Yet, this option was simply politically infeasible (Boycko, Shleifer, and Vishny 1995). The main reason for this is the (post)empire syndrome: sales to foreigners prove to be politically very sensitive in all big countries. Moreover, the combination of corrupt auctioneers with vested interests of home bidders makes sales to foreigners technically infeasible since foreign bidders de facto get banned from the auctions as was the case with Slavneft (*Financial Times* 2002) and the Yukos's "loans-for-shares" scheme (Chrystia Freeland 2000).

Thus, the analysis of Russia's initial conditions, i.e., widespread corruption and absence of rule of law, leads to the conclusion that measures that prolong the period of state ownership would have resulted in more looting and, as a consequence, even higher criminalization; while measures that involve cash auctions would have resulted in even higher corruption. Thus, neither of these alternatives to what actually had been done would have helped legitimization of the private property institution.

3.3 *Economic Efficiency of Privatization*

Up to this point, I have only considered *political* aspects of privatization and abstracted from its main *economic* goal—restructuring of Russia's industry. Yet, there is no agreement among scholars on the assessment of the effect of Russia's privatization on firm performance either. Privatization has been characterized as the "reformer's greatest success" and as "the biggest disaster." Throughout transition, Shleifer has been consistently arguing for the former.[9] Shleifer's opponents usually use the output fall of the first eight years of transition as the proof of the failure of privatization policy to bring in restructuring and growth (see, for instance, Stiglitz 1999). This argument, however, is hardly sustained once we consider the last instead of the first seven years of Russia's transition. Since the financial crisis of 1998, Russia has been experiencing sustained and rather strong economic growth: for eight years in a row, official GDP has been growing on average at a rate of almost 7 percent per annum in constant prices.[10] An alternative way to look at the productivity and profitability of Russia's private sector is to look at the dynamics of the stock market: since September 1995, the stock market index is up fifteen fold. Generally speaking, using macroeconomic performance of a country as evidence of the success or failure of a specific reform in a package of many essential reforms and with

[9] See Boycko, Shleifer, and Vishny 1993; Boycko, Shleifer, and Vishny 1995; Shleifer and Treisman 2000; and Shleifer 2005.

[10] While there is not yet enough data for a quantitative decomposition of this growth, there seems to be a consensus on the most important explanations (Anders Aslund and Nazgul Jenish 2006; Erik Berglof and Ksenia Yudaeva 2005; IMF 2005; and Augusto Lopez-Claros 2005). The two most straightforward sources of growth are not related to Russia's reform. These are high commodity prices and devaluation of ruble in the 1998 financial crisis. Both provided Russia with extremely fortunate terms of trade. Experts agree, however, that growth could not have picked up without either of the following two factors. First, Yeltsin's radical reforms of 1991–96 and, in particular, completion of privatization created necessary preconditions for the subsequent growth and, second, the effects of favorable external conditions were strongly supported by continuation of liberal reforms and responsible macroeconomic policy during Putin's first term in power in 2000–2004.

a large number of confounding events in a background is not a grateful task. Thus, abstracting from possible externalities, one would like to look at the microeconomic evidence of the effects of privatization. The vast majority of existing firm-level evidence shows a positive effect of privatization on restructuring (see, for instance, Joseph R. Blasi, Maya Kroumova, and Douglas Kruse 1996; John S. Earle and Richard Rose 1996; Earle 1998; Earle and Saul Estrin 1998; Nicholas Barberis, Boycko, Shleifer, and Natalia Tsukanova 1996). None of these papers, however, are without methodological problems.[11] There is one paper—Brown, Earle, and Telegdy (2006)—with superior methodology; it explores longitudinal data. Brown, Earle, and Telegdy find a *negative* effect of privatization on productivity of Russian firms on average over the whole transition period controlling for firm-specific fixed effects and firm-specific time trends. The posivitive effects of privatization start to realize in Russia only seven years into the privatization program—much later than in Hungary, Romania, or Ukraine.[12] Therefore, (1) we would need more research to reconcile all pieces of empirical evidence and (2) at this point we have to turn to anecdotal evidence for answers. A large body of accumulated anecdotes collected from conversations with investment bankers and industry insiders (who observe transformation in Russia's industry from within) points to a mildly positive or zero effect of privatization on restructuring in the short run and a strong positive effect in the longer run. Stories suggest that, before consolidation of ownership was completed, both the managers of state and of privatized firms had tremendous incentives to engage in looting. Since firms that were privatized to employees and firms that have not yet been privatized had similarly few constraints on management, the actual productivity of state and privatized firms did not differ much in the early stages of transition. The picture had changed drastically after 1998 crisis. There is a consensus among all observers—including the proponents of renationalization—that since 1999 most of the growth has been concentrated in privatized and de novo firms (controlling for industry differences). There is lots of anecdotal evidence that, after macroeconomic growth picked up, privatized firms restructured while state firms did not (see, for instance, Evgeny Yasin 2005). It is important to note that, so far, there is no sound theory that would predict that state firms are more productive than privatized firms unless one is willing to assume a benevolent government—clearly a wrong assumption both generally and in the case of Russia (Shleifer 1998). At most, theory predicts that privatization benefits should be delayed until ownership gets consolidated in the hands of large outside owners (Adolf Berle and Gardiner Means 1932). Therefore, positive effects of privatization are expected to be delayed much longer in Russia and other CIS countries compared to most countries in Central and Eastern Europe due to differences in the methods of privatization programs and initial conditions in these countries. Evidence is consistent with this prediction. Did privatization help restructuring of Russian firms? While empirical literature gives a mixed picture, anecdotes overwhelmingly suggest the positive answer.

Overall, the longer term political economy perspective on the debate about privatization and the speed and sequencing of reforms seems to support the views of Shleifer rather than of his opponents.

[11] The vast majority of the empirical evidence is based on cross-sectional analysis and, therefore, is subject to selection biases. Thorough surveys of the vast empirical literature on the effects of privatization in Russia and other countries were done by Megginson and Netter 2001, Simeon Djankov and Murrell 2002, and Megginson 2005.

[12] Brown, Earle, and Telegdy's (2006) finding may be explained by the different treatment of state and privatized firms by the state throughout the transition in Russia, i.e., state firms have been granted tax breaks and received other preferential treatment substantially more frequently than privatized firms (Slinko, Yakovlev, and Zhuravsknya 2005). Moreover, different tax incentives may have led to systematic differences in underreporting of output between state and privatized firms, which could account for a part of the productivity gap between them.

4. *The Second Debate: Federalism and Political Centralization*

Probably the biggest puzzle in the transition literature is the Chinese economic miracle. Many papers try to provide explanations for this puzzle by singling out various peculiarities of institutional and cultural environment, stage of development, as well as of the speed, sequencing, and direction of transition in China. None of these explanations so far provided a satisfactory answer that would allow treating China not as a miracle but as a normal and comprehensible phenomenon. Nonetheless, many of these theories helped our general understanding of how the world works outside China or, at least, helped to pose the right questions.

One example is the grand debate about workings of federalism in developing and transition countries. In this debate, one strand of the literature argues that decentralization helps to create efficient incentives for local public officials through interjurisdictional competition and fiscal incentives. The Chinese system of fiscal intergovernmental relations is commonly used by this strand of literature as the main example of the beneficial effect of decentralization on growth. The other strand of the literature argues that decentralization leads to inefficient local policies because of local capture and incentives to pursue regionalist policies. Russian transition is often used to demonstrate the pitfalls of decentralization.[13] Overall, it has been shown that, in China, local governments fostered growth of small business by maintaining benign regulatory environment and providing growth-enhancing public goods; while in Russia, local governments impeded growth by excessive regulations, corruption, low public goods provision, and regionalist policies.

There have been a few attempts to reconcile the outcomes of Russian and Chinese federalism. Most of them focus on formulating conditions for the system of intergovernmental fiscal relations that need to be satisfied for federalism to function well. For example, such features as the clarity of the division of expenditure responsibilities and revenue sources between levels of government and the size and predictability of marginal remittance rates affect incentives of subnational governments to foster business growth and to provide public goods efficiently (for a survey, see Roland 2000). Indeed, there is some evidence of important differences in the fiscal intergovernmental relations between China and Russia (Zhuravskaya 2000; Hehui Jin, Qian, and Weingast 2005). Yet, these differences may not be enough to explain the vast disparity in the behavior of local governments. Moreover, a more fundamental question of why one of the two countries was able to institute and enforce efficient rules while the other was not is not addressed in those papers.

In chapter 9 of *A Normal Country*, Blanchard and Shleifer shed some new light on this debate by focusing on another major difference between Russia and China. They use the China–Russia comparison to argue that, for federalism to function, it needs to come with political centralization. This argument was first developed by William Riker (1964) who reasoned that only those local politicians, who have strong career concerns about promotion to national politics, can resist local special interests and internalize effects of own local policies on other jurisdictions in the country. Blanchard and Shleifer highlight differences in career concerns of local politicians in the two countries: On the one hand, the Chinese Communist party plays a crucial role in creating "national" career concerns for (fiscally autonomous) local public officials. In particular, it systematically

[13] The first side of the debate is represented by Charles M. Tiebout 1956; Yingyi Qian and Roland 1998; Eric Maskin, Qian, and Xu 2000; Gabriella Montinola, Qian, and Barry R. Weingast 1995; Qian and Weingast 1996; while the second side by Richard A. Musgrave 1969; Wallace E. Oates 1972; Remy Prud'homme 1995; Vito Tanzi 1996; Pranab Bardhan 2002; Hongbin Cai and Treisman 2004.

promotes governors whose regions performed well to the central government and dismisses governors whose regions performed poorly. In contrast, in the 1990s in Russia, fiscal decentralization occurred along with massive political decentralization so that the central government was left without political or administrative means to discipline governors.

Generally, there are two distinct ways to achieve political centralization: first, to have strong national political parties present in local elections; and second, to have administrative subordination, i.e., to appoint rather than elect local officials. There is an important difference in the positions of Blanchard and Shleifer, on the one hand, and Riker, on the other, about the effect of these two methods. Blanchard and Shleifer stress the importance of administrative centralization in China, although they highlight the possible costs in the form of toppled democracy. Riker's view was that, in most cases, administrative subordination is ineffective in disciplining local politicians—unlike strong national parties—because it may undermine potential benefits of federalism (such as better information about preferences of population at the local level) in the first place. The reason for this is that appointed officials may stop caring for preferences of local population even though they may know them better than central politicians. In contrast, when national parties are strong and local elections present, local politicians care both about the preferences of the local population and about the preferences of the national party. Using cross-section and panel data for up to seventy-five developing and transition countries for twenty-five years, Enikolopov and Zhuravskaya (2006) confirm Riker's view. They show that strong national parties are necessary for fiscal decentralization to result in higher economic growth and public good provision and in better quality of government; while appointing rather than electing local governments does not have a significant effect on the results of fiscal decentralization.

The China–Russia case study taken together with evidence of country-level regressions suggests the following two points. First, just as Blanchard and Shleifer argue, political centralization does matter for how well federalism functions both in general and in Russia and China in particular. Second, the necessary condition for administrative centralization without local democracy to discipline local governments (and, therefore, to help federalism function well) seems to be efficient growth objectives of central officials. Judging by Enikolopov and Zhuravskaya's (2006) results, this is not true in general. Thus, the great Chinese puzzle remains unresolved: it is still not clear why Chinese central government is well-behaved and how the Party manages to provide its officials in Beijing with incentives to act in the country's best interest. Understanding the fundamental reasons behind this is especially challenging given the 1980s experience of the Soviet Communist Party.

This last conclusion has an important implication for Russia's recent political centralization.

While this was never officially acknowledged, Putin seemed to have followed the Chinese model of political centralization. On September 13, 2004, Putin announced a drastic political reform. First, elections of regional governors were replaced by their appointment by the president. Second, direct majoritarian elections, which—prior to the reform—were held for one half of the seats in the lower chamber of the Russia's parliament, were replaced by proportional representation. At the same time, the threshold share of votes needed for a party to get into the Duma was raised. The official aim of the latter change was to strengthen the national political parties. In line with Riker and Blanchard and Shleifer, Putin justified this reform by the need for "securing the unity of state power and the logical development of federalism."[14]

[14] http://www.cdi.org/russia/johnson/9173-10.cfm.

Did this reform make local governance any better in Russia? The answer should depend on Putin's objectives. There are no empirical studies of the effects of these changes just yet. It will be very interesting to see the results when sufficient data are accumulated. It is not easy, however, to reconcile the record of reappointments up to this point with a theory of using administrative centralization as a disciplining device for the governors. A more plausible story to me is that the ability to dismiss governors is used by the central administration to receive a (larger) share of governor's rents. Thirty-nine out of forty-eight governors were reappointed up to now. Among those thirty-nine, a few governors are well known for pursuing policies that were in massive violations of the Russia's federal legislation; several are widely recognized as local mafia bosses.

The most striking example is reappointment of the governor of Kalmyk republic, Kirsan Ilymzhinov (reappointed on the 24th of October 2005). Before being reappointed, Governor Ilymzhinov had truly abysmal performance throughout his twelve-year governorship. During this time, Kalmyk republic was the first (and so far the only) region in Russian history to officially declare bankruptcy because the past-due debt of the republic exceeded the annual budget of the region. Over the last twelve years, the region was one of the slowest growing in the country. Russia's Accounting Chamber investigated the region and concluded that Mr. Ilymzhinov systematically diverted federal transfers from the Kalmyk budget. Mr. Ilymzhinov has the biggest Rolls-Royces collection in Russia, yet his region is among the seven poorest regions in the country. In 1998, the most prominent critic of Ilymzhinov, journalist Larisa Yudina, was abducted and murdered. President Putin awarded Ms. Yudina with a posthumous award for courage. Human rights organizations make accusations that she was killed on the orders of Mr. Ilymzhinov. It is widely known that there were grotesque manipulations of election results when Kirsan Ilymzhinov stood for reelection in 2002. Despite all of this, Kirsan Ilymzhinov was reappointed by Putin for his fourth term as Kalmyk governor, which allows him to rule the region for nineteen years in a row because the length of each gubernatorial term in the republic is now seven years.

Apart from redistribution of rents toward bureaucrats in the center, there could also be political benefits of negotiating with even the most notorious governors (instead of dismissing them). Politically unpopular misbehaving governors are more dependent on Putin and cannot appeal to the public against Putin. If Putin dismisses the most corrupt governors and the new appointees do a good job, they may become politically strong and independent (and, potentially, they may organize opposition to the president in the future).[15]

Thus, the assumption of a benevolent or growth-maximizing national government does not seem to be consistent with Russia's political centralization model. If this is true, we should not expect Putin's political centralization to affect local governance, instead, it may just redistribute rents toward the center.

Another possible (related) outcome of political centralization is that a strong central bureaucracy may face a commitment problem in maintaining local governments' fiscal autonomy. The desire of central politicians to appropriate control may lead to fiscal centralization following political centralization. This is essentially what happened in Mexico in 1980s. It is important to note, however, that this happened only after a few decades of a remarkable growth of a federalist system under PRI's political domination which was perfectly consistent with the Riker–Blanchard–Shleifer model.

[15] Overall, mediocrity seems to be a very important feature of many key figures around Putin. For example, Aslund (2005a) characterized Russia's Prime Minister Mikhail Fradkov as "a man famous for never making any decisions" (p. 4). Georgy Egorov and Sonin (2005) show that autocratic leaders have incentives to avoid choosing able and smart people as advisors and closest allies.

5. *The Third Debate: Russia's Normalcy*

A very heated debate erupted around the views that Shleifer and Treisman expressed in an article that gave the title to *A Normal Country* and became its closing chapter. Shleifer and Treisman argue that Western scholars and policymakers who view the Russian transition as a disastrous failure misperceive its effects. The reason for this is their failure to understand what the appropriate comparison group is. While many observers would expect Russia to be at par with OECD countries, Shleifer and Treisman argue that Russia should be compared to a group of middle-income countries. Having a comparison group for Russia consist of countries with GDP per capita at purchasing power parity around $7,000 to $11,000 leads to the following conclusion. The challenges that Russia is facing in terms of both economics and politics (e.g., corruption, inequality, state capture, macroeconomic instability, immaturity of democracy, and political control over media) are typical for this level of income and it is unreasonable to expect from Russia to have a level of social, political, and institutional development much above that of other middle-income countries. Considering that, only a quarter of a century ago, Russia was an "evil empire" that oppressed many neighboring nations, presented a terrible threat to the outside world, and had trouble feeding its own people, Russia's transition should be considered an extraordinary achievement. The two main characteristic features of the former empire are gone for good: on the political front, Russia freed itself of the Communist ideology; on the economics front, the system of central planning was replaced by markets and private property. Overall, Shleifer and Treisman characterize Russia as of November 2003 (when the article first appeared as a NBER working paper) to be a "typical middle-income capitalist democracy."

To make their point, the authors provide various pieces of evidence that Russia's problems are either *overstated*, i.e., are lower in reality than it is customary to think, or *overstressed*, i.e., are common to other countries with similar income. For example, overstatement relates to country's economic decline in the first seven years of transition and overstress relates to Russia's corruption and inequality.

Many criticisms of this article appeared in various media sources and academic press (see, for example, Steven Rosefielde 2005; Vlad Ivanenko 2005a, 2005b; and Vladimir Shlapentokh 2004). Some critics agree with the main ideas but disagree with the methodology; the others argue that the relevant comparison groups for Russia is G-7 (since, for instance, Russia was the G-8 chair in 2006) and that by G-7 standards Russia is extremely abnormal; yet other critics argue that Russia has not made much progress from its central-planning and communist past and still should be characterized as an authoritarian martial police state with imperial ambitions and feudal economic system much different from Mexico's or Argentina's.

As far as the first two types of criticisms (above) are concerned, they are simply irrelevant for Shleifer and Treisman's article. The first overlooks the simple differences between genres: *A Normal Country* is not supposed to have rigorous econometric analysis because it is not an academic paper but rather a popular summary of views held by academics backed up by a colorful collection of anecdotes (thus, criticizing empirical methodology in what is not an empirical paper is somewhat deceiving). The second simply misses the meaning of the article as well as of the word "normal." The third view is certainly relevant and, effectively, represents the set of arguments which Shleifer and Treisman are debating with.

Let me state my view on the subject of the debate. The reason why I feel that I could possibly suggest myself for the role of an arbiter in this debate is that Shleifer and Treisman's critics expressed serious doubts whether Russians would agree with the main arguments of the article; they directly accused Shleifer and Treisman with "disregarding the views of the Russian intellectuals and politicians" (Shlapentokh 2004). I certainly cannot speak for all of the Russian intellectuals and even less so for Russian politicians, but the fact that I live in Russia and was born and brought up in the Soviet Union, hopefully, gives some credibility to my views. I fully agree with the Shleifer and Treisman's characterization of contemporary Russia as "a normal middle-income country." Russia now has a level of development and (most characteristic features) of a typical middle-income country. A striking example of this is the extent to which transition and development literatures have converged. Many crucial issues in countries with similar (intermediate) income levels are very similar irrespective of whether they have gone through a period of communist dictatorship in their histories or they have not. Russia is not an exception.

First I would like to offer a couple of considerations in favor of two points made by Shleifer and Treisman which, for some reason, triggered an outrage among many Sovietologists and, then, I will come to discussing prospects for democracy in Russia that I (unlike the authors of "A Normal Country" chapter) see as rather grim in the short run.

Shleifer and Treisman provide a set of important reasons why Soviet economic development was significantly overstated while Russia's GDP was significantly understated since the start of reforms. The first argument is built around the fact that Soviet national accounting summed up useless output and wasteful investments at arbitrarily inflated prices (this point, actually, was first raised by Sovietologist Abram Bergson 1961). The second argument stresses the importance of unreported (unofficial) economic activity during Russia's transition. These two building blocks are used by Shleifer and Treisman to make a case that the decline of output and especially that of living standards during transition was lower than officially stated and commonly perceived. Surprisingly, these two extremely intuitive points were not well received by Sovietologists. For example, Rosefielde (2005) believes that the under- and overestimations could not possibly be enough to warrant the claim that the post-1991 decline was reversed by 2003 as Shleifer and Treisman suggest. Indeed, the confidence in the Soviet GDP figures as well as in the estimates of Russia's unofficial economy are not very high. Moreover, one may want to look at the most conservative estimates just to be on the safe side. Yet, the latest Russia's growth dispels any apprehensions. Even according to the most conservative forecasts, real per capita GDP is expected to reach the level of 1991 by the end of 2006. At purchasing power parity terms, Russia's per capita GDP overshot eleven thousand current U.S. dollars in 2005 and is forecasted to reach twelve thousand in 2006 compared to just above eight thousand dollars in 1989 and just below six thousand in 1998. As a person who lived in the Soviet Union and lives in Russia now, I can testify that it is completely obvious that the prosperity of the Soviet economy was a big fake and that the current Russian growth is real.

Shleifer and Treisman's critics also argue that the numbers about the dynamics of living standards are not representative for the lower end of the income distribution. Yet, there is no doubt that the post-1998 growth has been affecting all the social strata, including the most economically and socially vulnerable. Since 1998, poverty and unemployment decreased by over one third in Russia. Real wages (including wages in the public sector) and pensions doubled in real terms and quadrupled in dollar terms. Retail lending also has taken off: the stock of loans to households has been doubling every year since 2000 and reached 6 percent of GDP in 2006. Growth is affecting the middle class as well, of course: Mobile phone penetration went up from less than 1 percent in 1998 to 86 percent in the beginning of 2006 (in the two largest cities, cell phone penetration is above 100 percent). Internet use is up to about 20 percent of the population. Small business has been growing both in numbers and, more importantly, as shares of employment and GDP. Overall, it seems indisputable that by 2006 the majority of Russians are better off economically than they were before transition had started.[16]

Thus, an important but not sufficiently explored question is why many polls indicate that a substantial part of the population (i.e., over 40 percent in 2006 according to an independent polling firm, Levada Center) agrees with the statement that "it would have been better if the social and economic order which existed before transition would have been preserved?" Economic psychology and economic sociology suggest a few possible answers. First, stress associated with increased uncertainly is likely to be an important contributor to peoples' discontent (Elizabeth Brainerd and David M. Cutler 2005). Second, it could be the case that the majority of Russians care about their relative standard of living rather than the absolute level. Thus, increased inequality added another worry to their difficult lives—the need to "keep up with Ivanovs" (Andrew B. Abel 1990; Lars Ljungqvist and Harald Uhlig 2000; Claudia Senik 2005). Third, the level of life satisfaction may depend on the wedge between the actual living standards and a reference point that is determined by expectations (Robert H. Frank 1997). Since at the beginning of transition many (unreasonably) expected to accomplish prosperity rather quickly, the current discontent may be explained by the unfulfilled expectations. Last but not least, to a large extent, such negative answers can be explained by the deficiencies imbedded in retrospective questions. People tend to remember good things and to forget bad things of their past. They also often fail to take into account that they may have felt happier and healthier a long time ago simply because they were younger (Edward Gutek 1978; Scot Burton and Barbara A. Blair 1991; Ed Diener 1994). Consistent with these explanations, similar answers to analogous polls are received in most other transition countries, including those that are commonly perceived as successful cases of transition, like Poland and Hungary.

Shleifer and Treisman's discussion of Russia's political transition also generated a lot of debate. They characterize contemporary Russia as a democratic state. They argue that Russia's democracy is young, imperfect, and immature—just as it is supposed to be in a middle-income country—but it is still a democracy. Since the "A Normal Country" article came out, there has been a series of bad news about the prospects of Russia's young democracy. From 2004 onwards, Putin's administration openly went after political opposition, free press, and civil society (e.g., Aslund 2005a, 2005b). Judging by the recent political crackdown, problems with democracy in Russia are far more serious than those described by Shleifer and Treisman. In accord with recent Freedom House ratings and in contrast to Shleifer and Treisman, I could characterize current Putin's regime, at best, as mild authoritarianism rather than an immature democracy. Yet, in contrast to a number of middle-income Latin American counties, Putin's regime materialized not via a military coup but through a fairly democratic process with continuous majority support.

[16] Two sizable groups in the Russia's population—which seem to have been hit the hardest and for which the recovery may still be far from completed—are the pensioners and school teachers. These groups account for roughly a quarter of Russia's population. Their incomes, however, are growing very fast as well.

There is one fundamental problem with characterizing whether a country is democratic or not if the majority of population has no problem trading their political and human rights for economic growth. I have no doubt that, if there were an honest referendum held now, the vast majority would vote for extending the term limits for Russia's presidency and, if Putin stood for reelection in an open, fair, competitive, and free election (if only such election were possible now in Russia), he would win by a large margin. It seems that the median voter in Russia genuinely believes that some degree of authoritarianism in beneficial. The problem, of course, is that after allowing for authoritarian rule the changes in public sentiment become irrelevant. Putin and his administration used this myopic behavior of the Russian public quite effectively to close up all the channels for the opposition to develop.[17]

Shleifer and Treisman do acknowledge that normalcy as a middle income country predicts a wide range of possible outcomes. Implicit in their arguments, there seems to be a belief in the irreversibility of the changes Russia has gone through over the transition period. My view is substantially more pessimistic: a temporary reversal is not only quite possible but, to some extent, already happening both in the political and economic fronts. On the economic front, it is likely that we will observe continued renationalization and a further increase in the politicization of private firms due to perceived illegitimacy of private property. On the political front, further increase in authoritarianism is likely given the challenges that the current political elite face due to Putin's binding term limit of 2008.[18]

Overall, Shleifer and Treisman make a prediction that for Russia, as a normal middle-income country, extreme outcomes can be ruled out. Yet, a fairly extreme prospect of a short- to medium-term reverting to a political and economic regime that can be characterized as "Autocratic Market Socialism" (so well described in Shleifer and Vishny 1994) is not at all unlikely. The main conclusion of Shleifer and Treisman's article about Russia's normalcy as a middle-income country, however, does not in any way depend on the premise of irreversibility of transition. On the contrary, both political and economic setbacks are normal for middle-income

[17] Most of the political developments at the initial stage of political consolidation during 2000–2004 (i.e., abolition of governor elections, antioligarch campaign, etc.) could have been interpreted as measures undertaken in order to increase efficiency of governance and to replace "state capture" by "political antitrust," i.e., to reduce the influence of special interests on policymaking (Raguram G. Rajan and Luigi Zingales 2003). Since 2004, there is little doubt that the real goal is to consolidate political power. One colorful example among many is the state campaign against all kinds of NGOs.

[18] The Putin's administration is facing a serious challenge of what to do in 2008. The Russian constitution clearly prescribes a two-term limit that requires Putin to step down. The ruling elite needs to design a mechanism of protecting assets appropriated through expropriation of Yukos, alleged Sibneft's kickback, and other deals. The best option would be to find a truly loyal successor. The problem is that ex ante promises of any potential successor not to expropriate the current elite ex post are not credible. The president in Russia has almost no constraints on his power between elections. Thus, if the successor is politically strong and enjoys majority support from voters, he will have no problem crushing vested interests—just as Putin did with Gusinsky and Berezovsky. If the successor is weak, he will not be able to initiate investigations of Putin's elite, but he also will not be able to win an honest election and, therefore, will lack legitimacy that will undermine his ability to protect the elite's property rights. Another option for the Kremlin is to design a legalistic solution that would allow Putin to stay in power. This option is not without a problem either. First, it seems that Putin is personally interested in retiring. Second, even if the median voter endorses the third term now, in the eyes of future generations in Russia and the West, Putin would be transformed from a legitimate political figure into an illegitimate dictator. It is not clear how much Putin cares about this, but it is certain that his concern needs to be very high to ensure that he steps down because the pressure to stay will be tremendous. The most optimistic scenario for Russia's democracy is if the Kremlin finds a strong successor who by a mere chance would turn out to believe in democracy. He would then press for reforms both in economics and in politics; and in that case, one could hope for competitive elections in 2012. In contrast, a pessimistic political scenario resembles Korea's under the Major General Park Chung Hee or Mexico's under PRI.

countries. The second half of the twentieth century witnessed many temporary (re)nationalizations and exits from democracy in the middle-income countries (e.g., in Latin America). It is quite likely that Russia's political and economic regime will not be very stable in the medium-term future. As Daron Acemoglu and James A. Robinson (2001, 2005) suggest, relatively high wealth concentration and inherent illegitimacy of property rights contribute to instability of political regimes. Even looking back in time (rather than into the future), a longer-term perspective on Russia's political process invites some parallels to Latin America: in the last fifteen years, Russia did actually experience two (attempted) coups: in 1991 and 1993.

6. *Conclusion*

Fifteen years since the start of transition are not enough to judge if Russia will catch up with the developed world in any foreseeable future or will freeze at the intermediate level of development indefinitely. Nonetheless, looking back at the recent transformation is extremely useful. There are two types of lessons that could be drawn: (1) whether economic theory was useful in drafting the actual policies in transition countries and, vice versa, whether transition was useful in testing existing economic theories and developing new ones; and (2) if the transition is over now. *A Normal Country* is a fascinating book. It not only gives answers to these questions backed by very powerful ideas but also contains all necessary inputs to allow the reader to draw his or her own lessons (possibly, at times distinct from Shleifer's). The book is an important contribution to the transition and development literatures: it shows that much can be learned by taking a longer term view. *A Normal Country* is definitely worthy of note for economists interested in theory of reform and institutional change, for political scientists interested in political constraints to policy choices, and for economic historians and scholars studying history of economic thought. More generally, anyone interested in Russia's transformation, its present and future, will find this book to be extremely stimulating: it is extraordinary to what extent issues discussed by Shleifer in relations to reforms throughout the 1990s are relevant to today's policies in Russia. Above all, *A Normal Country* is really fun to read.

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