



Andrei Shleifer and Daniel Treisman

Without a Map

Political Tactics and Economic Reform in Russia

MIT Press, Cambridge, Massachusetts, 2000, ix + 223 pp., \$25.95 (cloth).

ANDREI SHLEIFER and Daniel Treisman set out to evaluate the reforms of the 1990s by reviewing the reformers' political tactics. As advisors to Russian policymakers, they bring readers a firsthand knowledge of the reform process. Instead of asking the conventional question of what reforms are necessary, they focus on when and how reforms should be accomplished, given the politically feasible alternatives. They vividly illustrate how Russian reformers tried to build winning coalitions and co-opt, or neutralize, the "stakeholders"—those who stood to lose as a result of the reforms.

The book examines three major reforms—privatization, stabilization, and tax reform—and analyzes the price reformers paid to co-opt their opponents, including enterprise managers, banks, and regional governments. Stakeholder analysis is especially useful because it allows the reader not only to enjoy the authors' fascinating perspective but also to question their assumptions about the politically feasible alternatives and whether the benefits were worth the costs to the reformers and society at large.

Shleifer and Treisman consider Russia's mass privatization—one of the largest and fastest transfers of property rights ever to occur in peacetime—a great success. While acknowledging

that it resulted in poor corporate governance, they maintain that restructuring will eventually occur. In their view, the price was well worth paying: reformers succeeded in overcoming the opposition of powerful incumbent enterprise managers, or "insiders," who had held a controlling stake in 14,000 enterprises. In the book's preface, Shleifer and Treisman argue that their analysis of the reforms is based on a comparison with the alternatives that were politically feasible at the time—the counterfactual scenario—but they do not, in fact, analyze these scenarios at any length. For example, they do not seriously analyze the costs and benefits of a counterfactual privatization scenario—a slower conventional privatization in 1991–97. Their argument that any alternative form of privatization would have been as corrupt as the "loans-for-shares" scheme (see below) is unconvincing, as is the case against a delayed but well-planned privatization.

The authors view the 1995–97 stabilization of inflation as another successful reform. Stabilization was achieved by co-opting the banks—maintaining an artificially high interest rate on treasury bills, in which the banks invested, and giving away shares in the best companies to banks under the loans-for-shares program. Was the price worth paying? Russia's 1998 financial crisis demonstrated the fragility of this stabilization, which was based on borrowing rather than on cutting expenditures. At the same time, the concessions helped to consolidate the oligarchs' power, which was backed by their control over banks and energy companies. Another cost was the substitution of implicit energy subsidies, provided by energy monopolies, for budget subsidies and directed credits to enterprises. The energy monopolies, in turn, received compensation from the state in the form of tolerance of their tax arrears. The replacement of direct subsidies by tax arrears, nonpayments, and, consequently, barter reduced fiscal transparency and efficiency. It also strengthened coalitions among regional governments, local

utilities, and loss-making enterprises. These coalitions became a major barrier to entry for new enterprises and made it impossible to level the economic playing field, creating the Russian "virtual economy."

The book's strength is its analysis of the pathologies of federal finance and the authors' concrete proposal for tax reform. Russia's main problem, they say, is the failure to construct "a democratic, fiscally stable, federal order on the ruins of a Communist state." As the central institutions weakened, regional authorities used their newly acquired power at the expense of both the federal and the local governments. The book emphasizes an important link between the unfinished tax reforms at the subnational level and weaker growth prospects for the Russian enterprise sector. The authors make a strong case for eliminating tax sharing between the three levels of government and, especially, for making local budgets a single beneficiary of taxes paid by small businesses. The latter would provide local authorities with incentives to protect small businesses from harassment and reduce barriers to entry. Still, the tax reform is treated too narrowly in the book: tax-sharing arrangements should be reformed in the context of general reform of the fiscal federal model, which should include changes in both expenditure and tax sharing as well as in budget transfer mechanisms.

In their conclusion, Shleifer and Treisman stress the specific political obstacles to reform in Russia: concentration of power in the energy and natural resource sectors and peripheralized federalism. This interesting book makes a significant contribution to the ongoing debate about Russian reforms. It is well worth reading, although readers might also be interested in the different perspective on the reforms in the book by Grigory Yavlinsky and Serguey Braguinsky, *Incentives and Institutions: The Transition to a Market Economy in Russia*.

**Itzhak Goldberg and
Lev Freinkman**



Henry Kaufman

On Money and Markets

A Wall Street Memoir

McGraw-Hill, New York, 2000, xi + 388 pp., \$24.95 (cloth)

HENRY KAUFMAN has built a career on predicting the future of interest rates, inflation, and the financial markets. Known in economic circles as “Dr. Doom” for his bearish forecasts, Kaufman’s approach stems from a deep understanding of market fundamentals and an ability to perceive change. While not everyone would agree with his forecasts, his acumen as an economic philosopher and analyst has earned him the respect of his peers. Whether you agree with his views or not, you cannot help but admire him. Moreover, you do not have to be a Wall Street investment banker to enjoy this readable and interesting book.

Kaufman’s memoir is really two books: a charming and inspirational tale of a German immigrant achieving the American dream, as well as a history of finance. The story begins in 1927 in a small village in Germany and moves to New York, where the family established a new life after being driven out following Hitler’s rise to power. Kaufman began school in the United States knowing no English and performed well. He writes that his family’s expectations for him were high; clearly, he never disappointed.

His childhood in the aftermath of the German hyperinflation played a major role in establishing his interests

in school and determining his career path. He acquired a unique respect for the destabilizing potential of such developments as the inflationary spiral in the 1970s, the rapid growth of debt in the 1970s and 1980s, the fiscal policy excesses of the 1980s, and the lack of fiduciary responsibility displayed by many financial institutions recently. His background instilled in him a sense of obligation to speak out against financial excess and weak policies when he believes they threaten our economic stability.

Kaufman began his career as a credit analyst earning \$45 a week at the People’s Industrial Bank. At night, he pursued his doctorate, which helped him establish important professional relationships and would later open doors for him at the New York Federal Reserve Bank. In 1962, Kaufman joined Salomon Brothers—which was not yet one of Wall Street’s largest investment banks—and was a trailblazer in research. The firm took a leadership role in pioneering new products; it dominated the derivatives market and moved into securities underwriting. Its assets grew from \$10 million in 1962 to \$230 million at the end of the 1970s and had increased another tenfold by the mid-1980s. Kaufman’s career soared in lockstep with the firm’s emergence as one of the largest, most sophisticated investment houses on Wall Street.

In the mid-1980s, Salomon began to accelerate its efforts to develop its high-profit margin business. Kaufman felt uncomfortable with the new direction and resigned in 1987. His decision to leave Salomon was extraordinarily painful, but he recounts the story without bitterness.

In the second half of the book, Kaufman shifts from memoir to a history of finance. I found this part of the book more interesting. In timeline fashion, he shares his vast knowledge on topics ranging from America’s contributions to finance, to the development of financial forecasting, and follows with a tutorial on the U.S. Federal Reserve Board. This last topic

is particularly engaging because Kaufman recounts how the Federal Reserve has interacted with various presidential administrations to formulate economic policy. He then traces the evolution of the Federal Reserve Board’s role from World War II to the present, describing its strengths and weaknesses. He doesn’t back any one policy but rather explains the advantages and disadvantages of each.

“Dr. Doom” hits his stride in the final third of the book in his discussions of regulation, financial crisis, and the shortcomings of economics and finance. He raises numerous concerns about the current level of regulation and supervision and expresses anxiety about the future of the current robust market. I question some of his predictions in this area. For example, when he writes that Congress is likely to enact more ambitious financial restructuring legislation in the next decade, he seems to completely disregard the fact that it took more than 60 years to repeal, in 1999, the Glass-Steagall Act. The repeal was arguably quite timid, abolishing portions of this law that had erected a wall between the banking and securities businesses. It did not address issues of commercial ownership or so-called universal banking.

Kaufman’s insights are deep and thought provoking, but readers should beware. He is extremely cautious and risk averse, and his outlook for the future will hardly leave you irrationally exuberant.

Kristin Roesser

Credits

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