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Russia's Macroeconomic Stabilization Revisited*

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Russia muddled through macroeconomic stabilization after late 1993 when a massive amount of credit issue by the Russian central bank stopped and interest rates turned positive. A process-oriented explanation ascribes the lowered inflation rates to the introduction of government bonds that yield incredibly high returns. It makes large commercial banks take an anti-inflationary position. Instead of solely emphasizing the elite's strategic choices however, in this article I will look at what political circumstances make these choices available and effective. I associate the macroeconomic stabilization with political opportunity structure for rent-seekers and their collective action dilemma. In this discussion, the 1993 constitutional crisis and subsequent party polarization are emphasized. I also argue that privatized state institutions deprive rent-seekers of the ability to take collective actions as time goes.

Keywords: Russian Macroeconomic Stabilization, Political Opportunity Structure, Diminishing Collective Action, War of Attrition

1. PROCESS OF MACROECONOMIC STABILIZATION IN RUSSIA

State autonomy theory argues that macroeconomic stabilization requires a strong state insulated from interest groups (Haggard and Kaufman 1995). Strong interest groups and the weak state defined Russia throughout the Yeltsin period. Therefore, according to the state autonomy theory, it is quite puzzling that Russia continued to lower inflation rates after the early high inflation rates due to the so-called "shock without therapy."

Treisman (1998) provides an interesting explanation for this puzzling success of Russian macroeconomic stabilization. He maintains that macroeconomic stabilization in Russia was peculiarly achieved through letting powerful bankers buy state securities whose returns were set artificially high. According to him, providing economic rents in a different form made the Russian bankers change their preference from being in favor of inflation to being opposed to it. Furthermore, the possibility of political opposition from the Russian enterprises who critically depended upon soft-credits for their survival was preempted by building arrears with the energy sector.

This interesting explanation, however, does not ask why Russian rent-seekers gave up their previous rights and methods that made more money in exchange for selective incentives that were less lucrative overall. Simply speaking, the Russian industries would have been better off if they had received cheap credits rather than free fuels.

In the year 1995, the Russian economy showed a remarkably low inflation rate compared to the previous years. So, with regard to Russia's macroeconomic stabilization, the year of 1995 has been focused upon by Triesman and others.

However, if we instead examine inflation rates in Russia for this period on a monthly basis, a rather different picture emerges. Once we trace the trend of monthly CPI, a significant change in macroeconomic stabilization becomes apparent from the last months of

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1993 and the first months of 1994. Around this period, there was a notable turn in the government's monetary policy to correct the loose monetary management that was directly responsible for hyperinflation in Russia. Indeed, the central cause of Russian hyperinflation was cheap credits to factories recording losses, mediated through commercial banks. Discounting rate of the Central Bank of Russia in November 1993 rose sharply. The "ex post real discount rate" turned positive in August 1993 before the real interest rate plunged to the negative, to as much as –70 to –80 percent a year. Easterly and Vieria da Cunha (1994) agree that 1993 was the turning point of Russia's monetary policy. As a result, the monthly rates of increase of the monetary supply declined from 32% in September to 6% in November (Gaidar 1995: 48). Gaidar (1995: 49) actually notes that "by November [1993] there was no longer a strong pro-inflation coalition." After November 1993, the significantly positive difference of the CBR discount rate from the inflation rate continued to be maintained (Blasi 1997: 133).

This study argues that the year 1993 is the turning point for Russia's macroeconomic stabilization. It is in late 1993 that inflation started to drop, as the government's monetary policy was increasingly tightened (Gustafson 1999: 90; OECD 1995: 37). This means that we need to investigate the variables that encouraged the tightening of monetary policy other than GKO bonds, to explain Russia's macro-economic stabilization.

In spite of these important changes in late 1993 and early 1994, as Treisman (1998) argues, recurring high inflation rates in the middle of April 1994 indicated that the government submitted to pressures from rent-seekers. This time, however, the main rent-seekers were regional governments and the agricultural sector. In fact, after 1993, we did not see any notable challenge from the so-called "red directors" and financiers who benefited most from the hyper-inflation.

Thus, in order to explain why this change took place and how the government had the ability to implement strict monetary policies at this time and under the given circumstances, I propose two hypotheses, based on the concept of the privatized state. Given my empirical evaluation of Russia's macroeconomic stabilization, I propose the following two hypotheses: **Hypothesis 1**. Political Opportunity Hypothesis: Reforms are unlikely to be initiated in the presence of a strong opponent who has the potential to recruit a large number of powerful rent-seekers into his/her political camp. **Hypothesis 2**. Collective Action Dilemma Hypothesis: A privatized state becomes more able to reform its economy as time goes on because collective action of rent-seekers becomes weaker and weaker in the privatized state.

In order to place these hypotheses in the proper context, it is necessary to first explicate what I mean by 'privatized state'. Following Evans (1998), I measure the state in terms of corporate coherence and rule-governed behaviors among state organs and their agents. Here, a privatized state is defined as "the lack of the ability to prevent individual incumbents from pursuing their own goals (Evans 1998: 12)." Here, the privatization of the state not only means its lack of insulation from private parties, but more importantly, it implies that the outcome of state institutionalization is hardly differentiated from private spheres, so no serious collective norms or values lead to a patterned behavior of state agents different from those of civilians. [1] The absence of shared objectives, the priority of personal interests over collective goals, the personal appropriation of public offices, the prevalence of agency

[1] In particular, what I mean by institutionalization is the process by which an organization is imbued with value so that its members form a collectively coherent view to be attached to it (Selznick 1957: 17).

opportunism, and unrestrained corruption are characteristics of the privatized state. In this study, I classify the Russian state as a typical case of a privatized state (Huskey 1999).

2. HYPOTHESES

1. FIRST HYPOTHESIS: Political Opportunity Structure for Rent-Seekers and Reform

Hypothesis: Reforms are unlikely to be initiated in the presence of a strong opponent who has the potential to recruit a large number of powerful rent-seekers into his/her political camp.

Political opportunity structure refers to the viable alternatives open to actors, in this case, the political alternative for rent-seekers to replace the reform-minded incumbent. Therefore, what is important here is how strongly rent-seekers are tempted to defect from their previously winning coalition. If there is a strong and attractive alternative for rent-seekers, the incumbent, afraid of their defection, will choose not to implement tightened monetary policies.

Two conditions should be met in order that a challenger may induce oligarchs to defect. First, the probability that a challenger will beat the incumbent should be great. Second, the main political support of the strong challenger should consist of a small faction of society, but one that includes a winning coalition of rent-seekers. In this situation, the reduction of rents is very likely to lead to the defection of rent-seekers to another political camp because defection is politically safe and economically profitable. Therefore, reforms are unlikely to be initiated in the presence of a strong opponent that has the potential to co-opt a large number of important rent-seekers into his/her political camp.

On the other hand, if a strong challenger relies for his power base on the population at large and does not win the loyalty of politically strong rent-seekers, this means that the size of the winning coalition becomes large and economic rent significantly diminishes for individual rent-seekers. In this case, there is no strong incentive for rent-seekers to join the challenger even though an incumbent chooses to reform. In fact, that ordinary people are politically activated by a challenger means that the degree of democracy is enhanced. This may strengthen the incentives for a leader to improve the economy.

We can find a similar argument from North (1981: 28). North argues that a ruler has two constraints; "a competitive constraint and a transaction constraint." Here, the competitive constraint means that a ruler should consider the rivals that strive to replace him. When politically significant constituents have access to alternatives, a ruler will not disturb their property rights, especially their rights for economic rent so as not to lose their political support.

This all implies that with respect to the provision of private goods (economic rents), political opportunity structure affects the relative bargaining power of the ruler with politically important constituents. Note that there is another factor that affects the bargaining power; collective action among rent-seekers which will be discussed later. The bargaining power constrains a ruler's policy choice and it determines the amount of rent for a significant constituent (Levy 1988: 10-2).

In this article, three factors are raised that affect the political opportunity structure of rent seekers; constitutional order, cleavage structure among interest groups, and party competition structure. First, in the area of constitutional order a power-sharing arrangement is particularly relevant to political opportunity structure. A constitutional grant of veto power or a significant decision-making power over multiple groups or institutions would increase political power of rent-seekers who are willing to take a side among multiple constitutional power centers. In the context of post-soviet Russia, semi-presidentialism before the 1993 Constitutional crisis[2] is an example.

Internal cleavages among rent-seekers are another factor of political opportunity structure. Suppose that there are two different strong factions in the economic elites — one occupies the industries of tradable goods, and the other engages in the businesses of non-tradable goods. In this situation, the reform of exchange rates might asymmetrically favor one side. When this happens, the betrayed party will defect from the dominant coalition to seek another political alternative, if one is available. This actually explains why the Russian government did not initiate loans for shares[3] to co-opt financial interest earlier.

When there are significant subgroups in the oligarchy whose interests are different from one another and political importance grants them veto power, reform attempts might be adrift. In particular, in the case where their interests are largely divergent, compromise would be difficult and their contention would resemble a war of attrition (Alesina 1994) to impose the costs of reform on the losing side. In this game, a ruler is unlikely to make a decisive action because his partisan decision would lose political support from a group of important constituents especially when there is a viable alternative. On the other hand, when subgroups lose their veto power cleavage structure becomes irrelevant to the politics of reform. Cleavage structure in the economic elites, in other words, works through factors that determine political importance of subgroups. This discussion leads us to examine the conflict between financial and industrial capital in Russia.

The structure of party competition is the third important factor that shapes the political opportunity structure of rent-seekers. The discussion of the political opportunity structure of rent-seekers leads to a new perspective on polarization in post-communist societies. When there is significant polarization between an incumbent and a challenging party, and when this broadens the policy distance between rent-seekers and the challenging party, the latter is less likely to be a political alternative for them. Therefore, a leader who is less fearful of the defection of rent-seekers may initiate reform to hurt more or fewer of their interests.

On the other hand, if there is a strong contending party near the policy position of the incumbent, the policymaker could not reduce the provision of private goods for his powerful constituents. At least a strong centrist might be threatening to the reform-minded incumbent. Here, the polarization of party politics might contribute to the improvement of a ruler's bargaining power by weakening centrist parties. Russia's macroeconomic stabilization will be examined around these three factors.

2.2. SECOND HYPOTHESIS: The Collective Action Dilemma of Rent-Seekers and the Dynamics of State Autonomy[4]

[2] It refers to the constitutional conflict between Yeltsin and Parliament in 1993, which will be discussed later in detail in chapter 3.

[3] It refers to the government decision that loaned money from Russian bankers providing shares of state-owned industries as collateral.

[4] The second hypothesis part, especially the following first two propositions, is an expanded version of what appears on the author's article in the Korean Political Science Review (Han 2005: 105)

삭제됨: to them

> **Hypothesis**: A privatized state becomes more politically able to reform its economy as time goes on because the potential for collective action of rent-seekers becomes weaker and weaker under a privatized state.

This study argues that the privatized state weakens society and makes it unable to form strong collective action. It makes three propositions to explain the social consequences of the privatized state. First, a privatized state is likely to strengthen the concern for relative gains in society, which in turn frustrates the cooperation that might otherwise be easily realized. Second, a privatized state is likely to make it hard for players to enjoy a long-term time horizon and to hinder cooperation. Third, a privatized state encourages social groupings based upon a narrow but strong group boundary and produces a fragmented and parochial society. This makes it disadvantageous for extensive reciprocity to spread trustworthiness and "norms of generalized reciprocity." Therefore, extensive cooperation with outsiders is unlikely to happen. In short, a privatized state, causing the intensification of concern for relative gains, a shortened time horizon, and disconnected social groupings, decreases the possibility of social cooperation.

All of this means that the collective action of rent-seekers becomes weaker and weaker under the privatized state. This has a significant implication for reform politics. As time goes on, a privatized state will become more able to reform distorted economies than before, not because it is insulated from social pressures, but because the vested interests cannot take collective actions effectively.

A privatized state is likely to increase the centrality of relative gains because it increases zero-sum conflicts in society. Such a state is very willing and able to transfer public resources to a private party whenever a minimum amount of material incentive attracts the agency's opportunism. The distribution of wealth and power through the private occupation of public domains resembles a zero-sum game, which means that one's gain is another's loss. Therefore, a privatized state vulnerable to parochial demand is more likely to increase the probability that the public is involved in a zero-sum game, everything being equal. As zero-sum situations become more frequent, the sensitivity to relative gains gets stronger. As Snidal (1991) convincingly demonstrates, as the pressure of relative gains increases, social interactions become non-cooperative.

Not only does a privatized state create an environment to transform cooperative interaction into a non-cooperative game, but it also undermines the possibility of conditional cooperation in an iterated non-cooperative game (Axelrod and Keohane 1985). A privatized state shortens the time-horizons and makes reciprocity unreliable, which in turn makes collective action for the public goods less likely to happen, since the widespread private occupation of the public domain creates a strong positional power. Positional power is generated when actors place themselves in certain strategic positions. Whoever has positional power is able to define terms and conditions unilaterally over others. We have to keep in mind that a privatized state maintains the unwavering ability to create exclusive private rights for public resources, since it is closely related to the personal interests of state agents. Institutionalized particularism in a privatized state makes it easy for individual bureaucrats to construct various entrance barriers that favor their clients. In short, positional power is easily and frequently created in a privatized state. The easy and frequent appearance of positional power makes a reciprocal strategy useless and greatly shortens time horizons. When a defector has strong positional power, utilizing a significant difference in payoffs between unilateral cooperation and defection, it will not be feasible for the defected to punish the defector because the defector will dictate terms and change the rules for the next encounter. Under such a circumstance it will be self-destructive to adopt a tit-for-tat strategy, to be nice in the first move and to maintain a long-term time horizon. In conclusion, a privatized state eliminates the two conditions for conditional cooperation; the feasibility of reciprocity and a long term time horizon because an initial defection produces a great amount of positional power.

A privatized state also discourages institutionalization and the creation of strong and extensive reciprocity. Gowa (1988) argues that intensive interest group formation is highly associated with the degree of "publicness" of political goods. For example, if state institutions allow the enactment of trade policies aiming at specific products, the low publicness of the political outcomes helps social actors that share narrow selective incentives to facilitate the strong collective action of small groups. A privatized state is likely to issue quasi-private political decisions to target a small number of clients. Also, the prevalence of agency opportunism makes a modicum of organizational resources in the private sector enough to obtain the personal favors of state officials. Therefore, under a privatized state vertically segmented social institutionalization is likely to occur, which hinders the practice of extensive reciprocity.

3. THE POLITICS OF MACROECONOMIC STABILIZATION IN RUSSIA

Until Yeltsin decided to resolve political tensions with parliamentary leaders through the bombardment of the White House, Yeltsin's main strategy was to solicit support from the political forces of industrial managers who politically maneuvered between him and parliamentary competitors. This political choice was directly responsible for high inflation rates in 1992 and 1993. I argue that Yeltsin's political economic choices were forced because of the political opportunity structure formed by semi-presidentialism and the coalition structure of political forces and industrialists who were able to fully utilize this political opportunity.

Right after the collapse of the USSR there were still no significant political groups to challenge the organizational power of industrialists from the old communist party (Mcfaul 1995). It is very obvious that social groups other than institutions related to the communist party were poorly developed throughout the Soviet period. The demolition of civil society for more than seven decades accounts for the fact that there were no other interest groups competing against industrial managers. Financial capital that later fiercely competed with the industrial sector had just begun to form thanks to the hyperinflation. As such, in the beginning of the hyperinflation the main interest group was industrial mangers. The cleavage between financial and industrial capital began to appear as the hyperinflation progressed and the financial sector earned a huge sum of windfall from a simple operation of soft credits.

The organizational power of industrialists was politically realized in the absence of a strong polarization that would force factory managers to fling to one side. Before 1993, there was no serious party polarization to tear off the centrists. To make them politically available, factory managers firmly stationed themselves in the center under the banner of the Civic

Union [5] between Yeltsin and his challengers. Ambivalent towards competing power contenders, they were willing to choose either the left forces including NSF, or the reform government to maximize their interests.

Had he abandoned the centrists in the middle of the deepening legislative-executive conflicts, Yeltsin might have jeopardized his political power. In fact, Yeltsin's political maneuvering showed a very strong centralizing tendency in 1992 and 1993, and political challenge from the Congress made Yeltsin move even further toward the side of the factory managers (Yeltsin 1994:168-9). In early 1992, Yeltsin decisively changed his economic policy to appeal to factory managers. Yeltsin started his policy change by removing his first deputy, Gennday Burbulis, who was a symbol of liberal forces in Yeltsin's regime, in April 1992. Above all, the removal of Lopukin, Gaidar's minister of oil, symbolized Yeltsin's policy distance from Gaidar and his reform team. It was only after Gaidar's bold movement to propose the resignation of his whole ministry that he succeeded in intimidating the Congress. Yeltsin made peace with the centrists in the Congress by removing Lopukin and replacing him with Viktor Chernomydin, who was strongly supported by the Civic Union, and was later named prime minister in December 1992.

As the conflict between the parliament and the executive escalated, Yeltsin strengthened political ties with Volsky, who was a former member of the CPSU Central Committee and a leader of the Russian Union of Industrialists and Entrepreneurs (RUIE), as well as the Civic Union. Yeltsin's efforts directly reflected the political necessity that he felt to maintain power. According to Shumeiko, Yeltsin thought that the political forces backing the Civic Union were more important for his political power than any other forces, such as Democratic Russia, the nationalists, or the communists (Reddaway and Glinski 2001).

Here, I want to call attention to the constitutional opportunities that were open to factory managers and their banks. Semi-presidentialism, which poorly delineated relationships between the legislative and executive branches, institutionally created a strong political challenge that might have had a real chance to win the leadership. Such political and institutional circumstances forced Yeltsin's choices, as expressed in an article in Izvestiia, titled "Yeltsin Concludes and Alliance with Civic Union" (Hough 2001: 144).

In the deepening legislative-executive conflicts, Volsky, the founder of the Russian Union of Industrialists and Entrepreneurs, behaved in such a way as the hypothesis expects. After April 1992, he appeared to have a significant political influence over policy-making in the government. After initially associating himself with Khasbulatov to issue an amended version of the government plan that demanded 1.2 trillion rubles, Volsky cut a deal with Yeltsin behind the scenes. In this deal the issue of 200 billion rubles was promised, as well as the recruitment of the so-called "red directors" into the government, as noted earlier (Lohr 1993: 823).

Yeltsin made a further concession in monetary policy and issued 500 billion rubles in the summer of 1992. And the new head of the Central Bank of Russia accelerated this process. Then soft credits became widely available for the industrial sector, in particular, for the virtually bankrupt state firms. Thanks to Gerashchenko, state firms recording losses eliminated their massive debts easily. He issued soft credits reaching over a trillion rubles from June to mid-September in 1992 (Lohr 1993: 824).

These extreme rent-provisions, however, started to change as the legislative-executive

[5] The Civic Union was an extra-parliamentary association and consisted of deputies who had been managers of state enterprises. It represented Russian centralism then (Mcfaul 1993).

conflict headed into a crisis, and Yeltsin became determined to implement constitutional change. In mid 1993, when there happened to be conflicts mounting to a deadlock between the President, Government, Parliament and the central bank, Yeltsin gave a television address on 20 March in which he announced a vote of confidence in his performance to be held the following month. Although there were no serious grounds to suspect foul play and vote fixing, a surprising 60% backed Yeltsin, and 53% backed the reform movement. On the basis of this, Yeltsin felt a bit more freedom to back the reformers that remained in the government, such as Anatoly Chubais, the deputy prime minister for privatization, and Boris Federov, the new finance minister, over the conservatives brought in by Chenromyrdin.

The crisis came to a head in mid-September, when Parliament began debates, stripping Yeltsin of his powers, and also tabled motions for a budget that would have dramatically increased social spending, and with it, hyperinflation. Yeltsin launched a preliminary strike and dissolved the Parliament on September 21, resulting in a hostile confrontation that was resolved violently, in Yeltsin's favor on 3-4 October. He then announced an election for a new Parliament and a referendum on a new constitution to be held on December 12. Yelstin once again returned his favor to the reformists, and he appointed Gaidar as First Deputy Prime Minister for economics, who quickly drew up a continuing program of liberalization, macroeconomic stabilization and various structural changes. Meanwhile, those closer to Yeltsin's inner circle began drafting a Constitution proposal that would institutionalize the President's recent political gains.

The introduction of the new 1993 Constitution and the move from semi-presidentialism to super-presidentialism greatly affected the political opportunity structure of rent-seekers. The new Constitution of 1993 completely amended the earlier form of semi-presidentialism, which was characterized by significantly circumvented presidential power, and considerable sharing of political power with the Congress of People's Deputies (Huskey 1999). Before the change, parliamentary leaders enjoyed a very secure institutional base. The new Constitution of 1993 gave Yeltsin political power that was virtually free of accountability to the Congress.

Indeed, the earlier semi-presidentialism institutionally created a strong political challenge from the Parliament that attracted Russian rent-seekers. This changed completely after the 1993 constitutional crisis. After the virtual removal of Yeltsin's accountability to the parliament, there was no institutional basis for the "war of attrition" to extract more rents (Alesina 1994). This is the reason why we can see the temporal coincidence of a tightened monetary policy and constitutional change. The newly approved Constitution institutionally eliminated a political alternative for rent-seekers.

Political polarization was another factor that changed the political opportunity structure of factory managers and commercial bankers. After the 1993 election, when the Civic Union and also the parties of the liberal reformists had suffered humiliating defeats, the Russian party competition became more and more polarized in the sense that there was no longer a significant central party, and Zuganov's Communist Party (CPRF) made a notable advance in the Duma. The CPRF platform clearly expressed the objection to market reform and endorsed the necessity of recovering state ownership. This meant that the CPRF was not such a reliable alternative for the pragmatic red directors as the Civic Union had been.

This change made it easy for Yeltsin to control and reduce the amount of rents. As mentioned earlier, the most significant change that affected factory managers the most was the considerable reduction of soft credits issued by the Central Bank. Ironically, this tight monetary policy was led by Viktor Gerashchenko, who became notorious among Western economists for his lavish credit supply in 1992. In the meantime, with this tight monetary policy, overall subsidies to enterprises also dropped rapidly. Overall, it is estimated that the amount of the total rents, which peaked in mid 1992, continued to decrease (Aslund and Dmitriev 1999).

4. DIMINISHING COLLECTIVE ACTION ABILITY AMONG RENT-SEEKERS AND THE PROCESS OF MACROECONOMIC STABILIZATION

The mechanism of the hyperinflation in 1992-1993 created another powerful interest group along with traditionally strong industrial managers; bankers in Moscow. The bankers earned a huge sum of windfall from the operation of soft credits issued by the Central Bank of Russia (Johnson 2000). This newly rising powerful interest group had a strong reason to sustain high inflation rates, as well as the industrial managers. The government with a weak state autonomy could not fight off both of the powerful interest groups at the same time in order to achieve macroeconomic stabilization. The government needed to wait for the time when either one became weak enough to acquiesce in bad deals.

After the bankers joined the politics of macroeconomic stabilization, Russia's macroeconomic stabilization process was associated with the dynamics of balance of power between financial and industrial capital. In 1994, the balance of power shifted to favor financial over industrial capital. Taking advantage of this change, the government stopped issuing soft credits to the factory managers that were the main cause of the hyperinflation in 1992-1993. Then, the government revoked the privileges of financial oligarchs and consolidated macroeconomic stabilization without further concessions in 1997.

Together with the deteriorating political opportunity structure for factory managers after 1993, their weakened collective action power provided the government with room to maneuver. During the heyday of the hyperinflation, the government could not impose costs for macroeconomic stabilization on either side because both were capable of imposing a credible threat on the government. Along with the dramatic change of the constitutional order and party polarization, diminishing collective action ability within and among interest groups allowed the government to escape the trap of "war of attrition" at the cost of factory managers. The following examines how interest groups under the privatized state lost their collective action power. The story begins with Russia's privatization.

Russia's privatization process really proves the importance of relative gains and positional power under the privatized state that weaken collective action ability of interest groups. Financial capitalists earned significant relative gains over industrial managers in the beginning of market transition. They then transformed their relative gains into positional power and became the biggest winners in a "winner takes all" economy. The financial capitalists, initially well-positioned to distribute soft credits, strengthened their political position through their initial relative gains. After this, they obtained almost every important piece of state property through the loans-for-shares auction.

According to my theoretical expectation, Russian industrialists and financial oligarchs are in general very likely to lose their ability to take collective action because of their relative closeness to the privatized state. During the heyday of privatization they were thus very susceptible to relative gains and positional power competition because of their high accessibility to rent-seeking opportunities in the privatized state.

Between these two powerful interest groups, Russian industrialists were the first victims to significantly lose the ability for collective action because of the privatized state. This was indirectly observed when the red directors lost their factories to the Russian financiers in the loans-for-shares scheme. More direct evidence is found in the dissolution of the Russian Union of Industrialists and Entrepreneurs (RUIE). Even within the single industrial sector, industrialists failed to make themselves into a strong interest group. The only exception was the gas sector because there was only one company in the whole sector: Gazprom (Lepekhin 1995, 71).

Collective action of factory managers once evinced a formidable power. At the time when the State Property Committee (GKI) led by Chubais, set a privatization plan to create outside ownership in very early 1992, factory managers collectively objected to the plan and drew a big concession from the government; they forced the government to abandon its original plan to convert state-owned industries to open joint stock companies (Boycko, Shleifer, and Vishny 1995: 3-81).

However, the strength of the collective action of the factory managers, originally strong enough to create de jure property rights of state-owned factories, rapidly dwindled after they succeeded in securing their rights. As discussed earlier, they then sought individualized deals with the government to enrich secured property rights (Cooks and Gimpleson 1995).

Indeed, survey research finds that there was a significant behavioral change among Russian industrialists between 1992 and 1993. Kharkhordin and Gerber (1994), surveying industrialists in St Petersburg in 1993, find that the boundary of the exchange of "mutual help" shrunk to include just an "essential few." A survey conducted a year ago reports that industrialists were prepared for cooperation with more than the "essential few."

Industrialists' diminishing collective action ability because of competition for more relative gains from the privatized state helped the government to achieve macroeconomic stabilization. The logic of the war of attrition suggests that if two important factions are in power parity, macroeconomic stabilization will be postponed because these factions, unable to incur any cost to each other, would tend to maintain the status quo (Alesina 1994). As soon as factory managers lost their collective action power after their creation of insider ownership and the 1993 constitutional amendment deteriorated the political opportunity structure of the managers, the power parity was broken and the government achieved macroeconomic stabilization at their expense. It stopped issuing soft credits to them. As a result, they experienced a serious liquidity problem, and inter-enterprise arrears and wage arrears were soaring (Woodruff 1999). Yet easy money for factory managers disappeared with no voices heard.

In contrast to factory managers that had to be satisfied with free energy instead of free money, huge windfall profits coming from the GKO bonds market[6] and the loans-for-shares that compensated bankers for their loss of free money were waiting for them. As a result of these, bankers (or "oligarchs,"[7] as they became known in the press) dominated the economy, and they appeared able to perpetuate the redistribution game of economic wealth by further privatizing the Russian state at the cost of the whole population.

Soon after the financial oligarchs successfully drew the compensations from the government however, they lost their collective ability because of their relentless myopic pursuit of relative gains. This completely eliminated the possibility to force the central bank

[6] It refers to federal state treasury bills whose returning rates were more than 200 percent in 1995 when the annual inflation rate was below 25 percent.

[7] It refers to a group of bankers who owned Russian industrial jewels such as oil and gas and wielded a great amount of political influence.

to issue another round of soft credits in the future. Otherwise, they might have demanded some free money to revive high inflation rates when the government made fiscal reforms to end easy money for them. As soon as they defeated the industrialists successfully and no challenging forces were near them, they started to fight each other to gain more than the other oligarchs. The growing intensity of internal conflicts among them culminated to the "bankers' war" in 1997, which had a devastating effect on the collective action ability of the financial oligarchs.

In 1995, at the beginning of the notorious loans-for-shares scheme that gave financiers huge economic favors, one of the leading financiers, Oneximbank head Vladimir Potanin, achieved quite considerable cooperation among the oligarchs in defeating the industrialists. Freeland (2000: 174) reports that Nevzlin, a partner of Mikhail Khodorkovsky, another leading financier and the head of Menatep Bank and Yukos Oil, said that "we [oligarchs] reached an agreement of who would take what. We agreed not to get in each others' way." As later became known, in the first round of the loans-for-shares scheme in 1995, the agreement was well respected, and each financier waited to take its turn as promised. Potanin was given free reign to single-handedly overcome the resistance of the factory manager of Norilsk Nickel; Khodorkovsky got Yukos oil without competition.

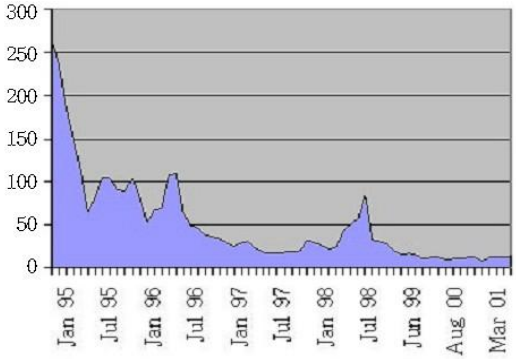
In the first round of the loans-for-shares, as oligarchs agreed, they cooperated successfully to steal very lucrative state properties from the red directors. This was a definite victory of the Russian financiers over the moribund industrialists. Their successful coordination continued to be practiced even after Berezovsky's Sibneft claimed its share. The power of cooperation among the oligarchs was demonstrated once again in the ability of the oligarchs to join forces to ensure the re-election of Yeltsin in the 1996 presidential election.

Potential conflicts based on concerns for relative gains began to appear as soon as Potanin was given the position of first deputy minister for finance and he developed a strong tie with Anatoly Chubais. This political tie challenged the bankers' arrangement. As soon as Potanin enjoyed strong positional power in the privatized state, he and his Oneximbank group claimed their right to participate in the auction of a 25% stake in Svyazinvest, a new telecommunication firm formed from the Soviet telecommunications infrastructure, and the biggest privatization chunk to date, in July 1997. The problem was that Potanin was playing out of turn, and his defection in the cooperation game that he himself set up allowed him to capture the Svyazinvest tender at an uncompetitive rate.

This incident led to the bankers' war. Berezovsky and Gusinsky, the communication moguls, used their television networks and newspapers to charge the "young reformers" of corruption. Chubais counterattacked Berezovsky to earn his resignation from the Security Council. This battle went on for moths under Yeltsin's wavering leadership.

In fact, this embarrassing tug-of-war made the government decide on policies disadvantageous for the powerful bankers. In July 1997, Yeltsin signed a decree that there would be no more privatization of state property like loans-for-shares (McFaul 2001: 253). Another important decision facilitated by the loss of collective action of bankers was to liberalize the GKO bond market. The returning rates of GKO bonds in 1997 decreased dramatically after the government decided to liberalize the GKO bond market (OECD 2000: 35).

Graph 4.1 Returning Rate of GKO Bonds



Source: Central Bank of Russia

This government decision to liberalize the market indicates that the large banks failed to secure their big source of profit. They became another victim who experienced collective action dilemma because of the privatized state. Their weak collective action ability actually explains why macroeconomic stabilization was not endangered even after the GKO bond market closed, which was tantamount to the disappearance of the most important selective incentive to "co-opt" the large banks for macroeconomic stabilization, according to Schleifer and Treisman. In fact, no free money was issued to calm down the disgruntled oligarchs.

5. CONCLUSION

In fact, a theory of "war of attrition" explains a significant part of the process of Russia's macroeconomic stabilization. According to the logic of the war of attrition, inflation is continued until there is a political solution to the question of who pays the costs for stabilization. In the Russian waiting game, the industrial managers were the first to lose their political power because of the constitutional change and the deepening polarization in party politics. It was not only that their political opportunity worked against them, but they also lost the ability for collective action in the middle of the privatization process. Since losing this ability, they never recovered it because of the constant shifts in property redistribution, thanks to the privatized state.

After this, factory managers received what they deserved. The amount of rent is a function of the political power of rent-seekers. Given their weak political power, factory managers had to be satisfied with free fuel and tax arrears to compensate for their loss of soft credits. Financiers enjoyed high interest rates on GKO bonds at their expense in the low-inflation economy from 1995 to 1998.

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