

How Capitalism Was Built

The Transformation of Central and Eastern Europe, Russia, and Central Asia

ANDERS ASLUND

Peterson Institute for International Economics, Washington, D.C.



Contents

List	of fables and Figures	page xi
List	of Abbreviations	xiii
Acknowledgments •		XV
	Introduction: A World Transformed	1
	Overview of the Arguments of This ¹ Book	3
1.	Communism and Its Demise	11
	Real Socialism	11
	Decline and Fall of Socialism	15
	The Demise of Communism in Central Europe	20
	The Collapse of the Soviet Union	23
2.	Shock Therapy versus Gradualism	29
	The Radical Reform Program: A Big Bang	31
	Gradual Reform Programs •	37
	Rent Seeking: The Scourge of Transition	47
	Criticism of Radical Reform after the Russian Financial Crash	53
3.	Output: Slump and Recovery .	57
	Sharp Decline in Recorded Output and Varied Recovery	59
	Exaggeration of the Slump	63
	Radical Reform: Least Decline and Early Recovery	69
	Late Reformers: Surged after 1998	75
4.	Liberalization: The Creation of a Market Economy	82
	Two Strategies of Deregulation "	83
	Liberalization of Foreign Trade	89
	Labor Market Policy	02

viii Contents

	Combat of Monopoly: Gas and Coal A Big Bang: Vital in Deregulation	96 101
5.	From Hyperinflation to Financial Stability	104
٥.	Establishing National Currencies	104
	Radical Fiscal Adjustment Was Key	111
	Tax Policy: From Social Democratic to Liberal	116
	Monetary Policy. From Loose to Strict	119
	Exchange Rates: Currency Board or Free Float	123
	Dramas of Financial Stabilization •	127
6.	Privatization: The Establishment of Private Property Rights	143
	Differing Aims of Privatization	144
	Small-Scale Privatization: If Started, Swiftly Done	154
	Large-Scale Privatization: The Biggest Headache	155
	Privatization of Land, Real Estate; and Housing	164
	New Enterprise Development: The Ultimate Success	165
	Great Achievements of Privatization .,	168
	Vital: Speed and Legitimacy of Property Rights	178
7.	An Inefficient Social System	. 1 8 2
	Incomes: Differentiation and Poverty	183
	Life and Health	187
	Education Adjusting to Demand	194
	Social Transfers and Pension Reform	197
	Three Alternative Social Models	203
8.	Democracy versus Authoritarianism	206
	Democratic Breakthrough: Critical for Successful	
	Transformation	207
	An Underreform Trap	215
	Renewed Democratization: Colored Revolutions	221
	Parties, Electoral Rules, and Constitutions	224
	How to Tame the Leviathan: Reform of the Communist State	230
	Public Opinion and Ideology	232
	Democracy and Democracy Aid	236
9.		241
	An Explosion of Crime	242
	Attempts at Building a Legal System	245
	Corruption: The Bane of Transition	249

1X

10. The Role of Oligarchs	256
Who Are the Oligarchs?	257
The Economics of Oligarchy	259
The Politics of Oligarchy	264
Complaints: A Matter of Ideology	267
A Question of Property Rights	272
Putin's Alternative: Centralized Dictatorship	276
11. The Impact of the Outside World	281
The Dream of Europe	282
Western Failure to Act in the East	286
Trade Pol icy: A Gulf between the EU and the CIS	292
International Assistance: Insufficient but Crucial	297
Conclusions: A World Transformed	305
Five Models	305
Achievements and Revelations	307
Why Certain Polices Worked and Others Did Not	311
Bibliography	315
Index	343