

OVERVIEW

PREFACE	i
OVERVIEW	iii
TABLE OF CONTENTS	iv
INDEX OF TABLES	x
INDEX OF FIGURES	xi
A. INTRODUCTION:	1
The Transition Crisis and the Economics of Transition	
B. CONDITIONS AT THE MICROECONOMIC LEVEL:	
FINANCIAL UNDERDEVELOPMENT AND MICROECONOMIC DISTORTIONS	31
I. The Role of the Financial Sector for Stability and Growth	35
II. Banking Sectors in FSU Economies:	
- Credit Allocation in Transition -	59
III. Enterprises in FSU Economies:	
- Corporate Governance in Transition -	85
IV. Transmission Mechanisms in FSU Economies:	
- Monetary Policy in Transition -	117
C. ARREARS, SOFT BUDGET CONSTRAINTS AND ENDOGENOUS MONEY	143
V. The Emergence of Arrears in FSU Economies	149
VI. Systemic Change, Collusive Arrears and Credibility	183
VI. A Microeconomic Explanation for the Macroeconomic Effects of Arrears	207
D. BARTER, HARD BUDGET CONSTRAINTS AND ENDOGENOUS VELOCITY	247
VIII. Monetary Disruptions and the Emergence of Barter in FSU Economies	251
IX. Modelling Barter and Demonetisation in FSU Economies	279
E. CONCLUSIONS:	311
Questions, Results and Policy Implications	
REFERENCES	I

TABLE OF CONTENTS

A. INTRODUCTION

The Transformation Crisis and the Economics of Transition 1

1. BREAKDOWN AND INITIAL HOPES	2
2. THE TRANSFORMATION CRISIS: THE STYLISED FACTS	4
2.1 Macroeconomic Disruptions	4
2.2 Macroeconomic Policies	7
2.3 Maladjustment at the Microeconomic Level	9
2.4 Open Questions	12
3. MACROECONOMIC ANALYSIS OF THE TRANSITION CRISIS	14
3.1 Keynesian Demand Explanations	14
3.2 Neoclassical Supply Side Explanations	16
3.3 Post-Keynesian Credit Crunch Theories	17
3.4 Monetarist Answers	18
3.5 Conclusions	20
4. THE MICROECONOMICS OF TRANSITION	21
5. THE APPROACH OF THE PRESENT STUDY	23

B. CONDITIONS AT THE MICROECONOMIC LEVEL:

FINANCIAL UNDERDEVELOPMENT AND

MICROECONOMIC DISTORTIONS

31

I. The Role of the Financial Sector for Stability and Growth 35

1. INTRODUCTION	36
2. THE ROLE OF THE FINANCIAL SECTOR IN A MARKET ECONOMY	38
2.1 Capital Allocation	38
2.2 Corporate Governance	40
2.3 Transmission of Monetary Impulses	46
3. THE ROLE OF THE FINANCIAL SECTOR IN A PLANNED ECONOMY	48
3.1 Institutional Features of Post-Soviet Financial Systems	49
3.2 Accomplishment of the Tasks Under Central-Planning	50
3.3 Macroeconomic Stability under Central Planning	51
4. THE ROLE OF THE FINANCIAL SECTOR IN THE TRANSITION	53
4.1 Stabilisation	53
4.2 Privatisation and Restructuring	54
4.3 The Sequencing Problem	55
5. CONCLUSIONS	56

II. Banking Sectors in FSU Economies	
- Credit Allocation in Transition -	59
1. INTRODUCTION	60
2. EARLY DEVELOPMENTS IN THE BANKING SECTOR	62
2.1 From Rigid Planning to the Gorbachev Reforms	62
2.2 Price Liberalisation and Banking Sector Expansion	63
2.3 The Break-up of the Ruble Zone	65
3. MICROECONOMIC BEHAVIOUR AND OPERATIONAL PROBLEMS	67
3.1 A Taxonomy of Banks	67
3.2 Corporate Governance in Banks	70
3.3 Problems of Credit Allocation	71
4. MACROECONOMIC IMPLICATIONS OF SYSTEMIC WEAKNESSES	74
4.1 Financial Repression: Regulations and Rules of Behaviour	74
4.2 Lending Boom and Credit Crunch	76
4.3 Bad credit and Perverse Incentives	79
4.4 The Interest Wedge and Disintermediation	80
4.5 Credit Rationing and Stagnation	81
5. CONCLUSIONS	82
III. Enterprises in FSU Economies	
- Corporate Governance in Transition -	85
1. INTRODUCTION	86
2. EARLY DEVELOPMENTS AND OUTCOMES OF PRIVATISATION	87
2.1 Enterprises Under Central Planning	87
2.2 Methods of Privatisation	89
2.3 Privatisation Outcomes	92
3. HYPOTHESES OF ENTERPRISE BEHAVIOUR	94
3.1 Enterprises are Not Allowed (The May-not Hypothesis)	94
3.2 Enterprises are Not Able (The Cannot Hypothesis)	97
3.3 Enterprises are Not Willing (The Will-not Hypothesis)	99
4. A SYNTHESIS: THE SURVIVAL-ORIENTED ENTERPRISE	102
4.1 Macroeconomic Instability and Uncertainty	104
4.2 Inter-Enterprise Coordination	106
4.3 Intra-Enterprises Cooperation	109
5. CONCLUSIONS	112

IV. Transmission Mechanisms in FSU Economies	
- Monetary Policy in Transition -	117
1. INTRODUCTION	118
2. THEORIES OF MONETARY TRANSMISSION	119
2.1 The Money View	119
2.2 The Credit View	123
2.3 The Developing Countries Perspective	126
3. TRANSMISSION MECHANISMS IN TRANSITION	130
3.1 Difficulties in the Application of Theories	130
3.2 Impediments to Monetary Transmission	131
3.3 Possible Transmission Processes in FSU Transition	133
4. MONETARY POLICY IN TRANSITION	135
4.1 Policy Objectives	135
4.2 The Choice of Instruments	137
5. CONCLUSIONS	139
C. ARREARS, SOFT BUDGET CONSTRAINTS AND ENDOGENOUS MONEY	143
V. The Emergence of Arrears in FSU Economies	149
1. INTRODUCTION	150
2. THE LEGACY OF THE PAYMENTS SYSTEM:	
A TECHNICAL APPROACH	152
2.1 Inertia of Payments System Procedures	153
2.2 Payments System Inefficiencies and Float	156
2.3 Abundance of Non-Cash versus Shortage of Cash	161
3. CREDITOR-DEBTOR RELATIONS:	
A PROPERTY RIGHTS APPROACH	165
3.1 Bankruptcy Laws and Non-Enforceability of Property Rights	165
3.2 Relationships Between Enterprises and Banks	167
3.3 Creditor Passivity: Missing Incentives	169
4. LOBBIES AND IMPLICIT CONTRACTS:	
A POLITICAL ECONOMY APPROACH	171
4.1 The Struggle over the Central Bank	172
4.2 Tax Arrears and Implicit Contracts	174
4.3 Wage Arrears: Ex Post Adjustment versus Inflationary Potential	176
5. CONCLUSIONS	178

VI. Systemic Change, Collusive Arrears and Credibility 183

1. INTRODUCTION	184
2. THE MODEL OF REFERENCE	187
2.1 Decision Rules of Enterprises	187
2.2 Formation of Rational Expectations	188
2.3 The Impact of Stabilisation on Adjustment and Arrears	190
2.4 Conclusions from the Model	192
3. CAUSES OF THE LACK OF CREDIBILITY	194
3.1 The Reputation of Monetary Policy-Makers	194
3.2 The Structure of the Economy	196
3.3 The Nature of the Credit Crunch	197
4. AN EXPLICIT MECHANISM OF COLLUSION	198
4.1 Non-Cooperative Games and Anti-Social Behaviour	199
4.2 A Formalisation of Contagion	200
4.3 Path-Dependency and the Role of Political Leadership	201
5. CONCLUSIONS	203

VII. A Microeconomic Explanation for the Macroeconomic Effects of Arrears 207

1. INTRODUCTION	208
2. CONDITIONS AT THE MICROECONOMIC LEVEL	211
2.1 Ownership Structures and Intra-enterprise Cooperation	212
2.2 Survival-Oriented and Inter-enterprise Coordination	214
2.3 The Passivity of the Banking System	217
3. MICROECONOMIC DECISION MAKING DURING TRANSITION	220
3.1 Assumptions	220
3.2 The Scheme	222
3.3 Results and Microeconomic Implications	227
4. A MACROECONOMIC MODEL OF THE POST-SOVIET ECONOMY	229
4.1 Assumptions	229
4.2 The Model	231
4.3 Results and Macroeconomic Implications	232
5. ACTIVE MONETARY POLICY	233
5.1 Raising Interest Rates	233
5.2 Monetary Restraint	234
5.3 Imposing a Ban on Arrears	236
6. CONCLUSIONS AND A PROPOSAL FOR A SHORT-TERM PROGRAMME	238

D. BARTER, HARD BUDGET CONSTRAINTS AND ENDOGENOUS VELOCITY **247**

VIII. Monetary Disruptions and the Emergence of Barter in FSU Economies **251**

1. INTRODUCTION	252
2. THEORETICAL CONSIDERATIONS ABOUT MONEY AND BARTER	258
3. PUSH FACTORS OF BARTERISATION	263
3.1 Dual Money System, Cash Shortages and Capital Flight	263
3.2 Taxing Procedures, Tax Evasion and Disintermediation	266
4. PULL FACTORS OF BARTERISATION:	268
4.1 Payment Inefficiencies, Banks and Fraud	268
4.2 Prepayment and Credit Crunch	270
4.3 Arrears and Survival-Oriented Enterprises	273
5. CONCLUSIONS	274

IX. Modelling Barter and Demonetisation in FSU Economies **279**

1. INTRODUCTION	280
2. CAUSES OF BARTERISATION	286
2.1 Push Factors of Barterisation	287
2.2 Pull Factors of Barterisation:	289
3. A MONETARY MODEL OF PULL FACTORS	291
3.1 Assumptions	291
3.2 The Model	295
3.3 A Simulation	297
4. A MONETARY MODEL OF PUSH FACTORS	298
4.1 Assumptions	299
4.2 The Model	301
4.3 A Simulation	304
5. CONCLUSIONS AND POLICY IMPLICATIONS	305

E. CONCLUSIONS

Questions, Results and Policy Implications	311
1. FACTS AND QUESTIONS	312
2. THE RESULTS OF THE ANALYSIS	313
2.1 Introduction	313
2.2 Financial Underdevelopment and Microeconomic Distortions	313
2.3 Arrears, Soft Budget Constraints and Money Endogeneity	316
2.4 Barter, Hard Budget Constraints and Endogenous Velocity	317
2.5 Conclusions	319
3. REFORMING MACROECONOMIC POLICY	320
4. REFORMS AT THE MICROECONOMIC LEVEL	322
4.1 Approaches to Banking Sector Restructuring	323
4.2 Approaches to Enterprise Sector Restructuring	326
5. OUTLOOK	327

INDEX OF TABLES

<u>Table A.1:</u> Growth Rates of Real GDP 1992-97	4
<u>Table A.2:</u> Index of Real Output 1992-97 (1991=100)	5
<u>Table A.3:</u> Inflation Rates 1992-97 (year end)	5
<u>Table A.4:</u> Velocity and Real Broad Money and Monetisation	6
<u>Table A.5:</u> Government Deficits 1992-97	7
<u>Table A.6:</u> Tax Revenues 1992-97 in % of GDP	8
<u>Table A.7:</u> Domestic Credit (end year) (% change) 1992-97	8
<u>Table A.8:</u> Investment, Unemployment and Productivity	10
<u>Table A.9:</u> Inter-Enterprise Arrears 1992-94; in % of broad money	11
<u>Table A.10:</u> Proportion of Barter Transactions in Russian Industry 1993-97	12

INDEX OF FIGURES

<u>Figure VI.1:</u> Path-Dependency and Political Leadership	203
<u>Figure VI.2:</u> Single Stable Equilibrium	203
<u>Figure VI.3:</u> Bandwagon Effect	203
<u>Figure VII.1:</u> A Circular System with Arrears and Viable Firms	210
<u>Figure VII.2:</u> A Linear Industrial Structure	221
<u>Figure VII.3:</u> Russia 1993-95 - Index of Prices and Trade Credit	240
<u>Figure VII.4:</u> Russia 1992 - Inflation, Arrears and Money - Real Indexes	240
<u>Figure VII.5:</u> Kazakstan 1995-96 - Real Arrears and Inflation	241
<u>Figure VII.6:</u> Russia 1993-95 - Real Indexes	241
<u>Figure VIII.1:</u> Share of Barter Turnover 1992-97	253
<u>Figure VIII.2:</u> Diffusion Indexes	253
<u>Figure VIII.3:</u> Barter Share in Turnover	254
<u>Figure VIII.4:</u> Alternative Means of Settlement - Share in Turnover	254
<u>Figure IX.1:</u> FSU 1993-95 - Growth of Money Supply and Prices	281
<u>Figure IX.2:</u> FSU 1993-95 - Growth of Velocity	281
<u>Figure IX.3:</u> Russia 1992-95 - Coefficient of Monetisation and Barter	286
<u>Figure IX.4:</u> Pull Factors of Barterisation - A Simulation	298
<u>Figure IX.5:</u> Push Factors of Barterisation - A Simulation	298
<u>Figure IX.6:</u> Push Factors of Barterisation - Optimal Barter Share	301