Waking from the Freeze: Russia's International Trade Policy in the Post-Soviet Era

Vicki Korchagin

Dr. J. Tybout
Econ 433 Honors Supplement
12/15/2006

The creation of a single Russian Federation out of the old remnants of the Soviet Union was much like the Russian fairytale of a girl, frozen alive by Father Frost, only to awaken with the kiss of a hero by melting. The Russian economy, woken by the touch of transition, also came to life, albeit in a much different manner. This paper seeks to trace the economic structure of the Soviet Union, its disintegration, and Russia's transition to an open economy using the two "workhorse" economic models: the specific factors model and Heckscher-Ohlin, as well as comparison to the West, and a comparison to two of its neighboring republics, Latvia and Kazakhstan.

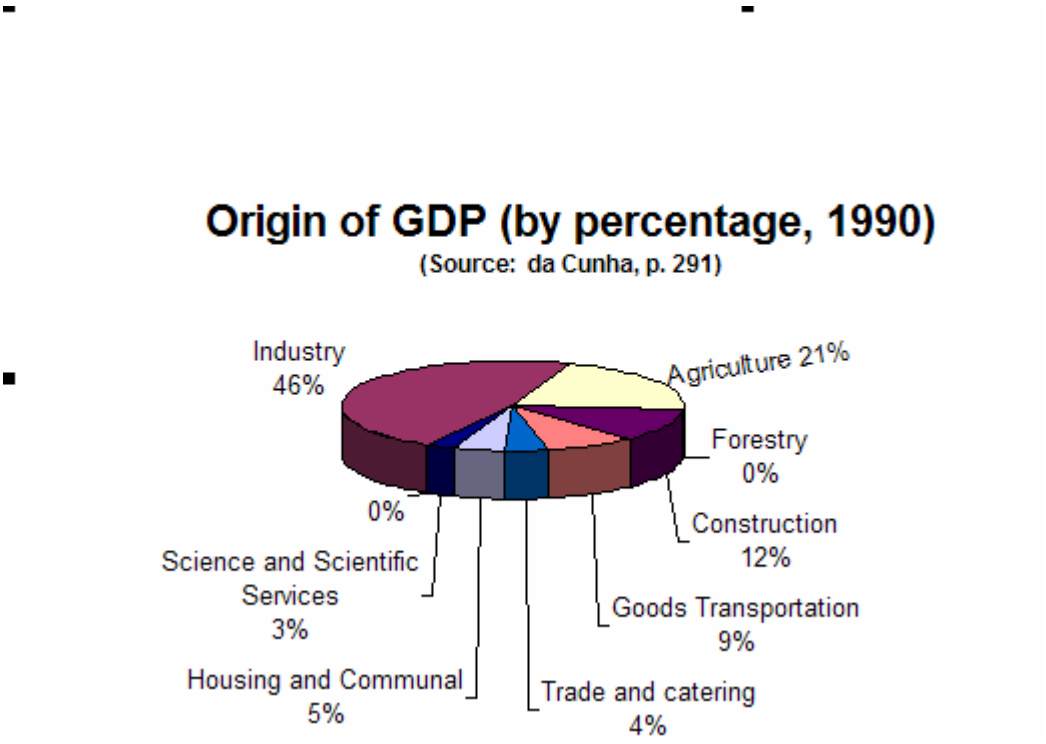
I. The Russian Economy: An Overview

Russia is one of the largest and most resource-rich countries in the world. This is remarkable, given that most of the country (over 70%) is taken up by Siberia, where the average yearly temperature is 32° F. Russia specializes in oil, natural gas, metals (particularly iron ore-Russia provides 1/6 of the world's supply (Curtis 1). Grains are also important, with the production of wheat and barley dominating (1). However, since only 10% of Russian land is arable, and only 60% of that is devoted to crop production, crop production declined during the Soviet era (2). During the 1920s and the 1930s, the rural economy was a major contributor in supporting and jumpstarting industrial development after 1880(Gregory and Stuart 25-27), after which it was severely ruined by the collectivization program.

The most important factor endowment for Russia is its energy and industrial sectors (see Fig 1.) Russia is one of the most energy-intensive countries in the world,

specializing in oil and natural gas deposits found in areas of Siberia, and Siberian fields carry enough raw petroleum to supply the world with 20-30% of total oil consumption (da Cunha 42). To date, Russia is the largest exporter of energy and the second largest producer of it in the world (xxv), and employs almost 43 million, or 60% of its working population in its energy sector. Indeed, some have gone so far as to say that energy "plays a central role in the Russian economy because it drives all other elements of the system, including industry, agriculture, commercial, and the government (Curtis 1)." However, the process of obtaining these difficult because of Russia's poor transportation system, huge distances between resources and refining centers, and inadequate production technology.

Fig. 1



The aggregate Russian economy synthesizes these inputs using its two basic factor endowments of capital and labor[1]. One of Russia's strengths is its labor sector. The population has always been proportional to Russia's size, resulting in one of the largest workforces in the world. During the Soviet era, the socialist model created a generation that was highly skilled the technical subjects, including engineering, math, and science. Literacy levels soared to over 99%. At least 92% of the total population finished secondary schooling, and women made up more than half of the work force (Curtis 2). This momentum has continued in the time of the Russian federation: in 1995, 57% of the population was working age and the literacy rate remained at astronomical levels (2).

The Soviet education system produced Russian workers that were focused on accomplishing highly technical tasks, meaning employment was concentrated in capital-intensive industries (See Fig. 2).

Fig. 2

State Employment by Sectors
in percent

	1980	1990
State Sector	72.5	73.2
Industry and Construction	42	42.8
Agriculture	15	13.4
Other	43	43.8

Excerpted from da Cunha, p.283

[1] An economy as complex as Russia has more inputs, but these have been simplified for theory and diagram purposes.

However, because of their concentrated training, Russian workers did not take classes in topics such as liberal arts or business, which allow for a different style of thinking required the an open, post-industrial economy that Russia has become.

Aside from an excellent education, another positive aspect of the Soviet system was an extremely low unemployment rate was planned labor demand, determined by a coefficient, much in the same way the rest of the economy was planned. Unemployment was considered a crime. Thus, when Russia opened to trade in 1991 workers were lost in a free market that did not demand the skills they had learned.

Similar effects occurred with capital endowments. During the twilight of the czarist era, Russia was an agrarian economy, very poor relative to its neighbors and main competitors, a state which it maintains today (Gregory and Stuart 3). See Fig. 3 for a comparison with the United States. Its industrial base was not well-established, and, to make it worse, production of capital equipment was limited in 1913.

Fig. 3

Outputs (in 1000 metric tons)

	Crude steel	Grain output	Rail lines (in 1000 km)
1861			
Russia	7	41,500	2.2
USA	12	39,318	39,318
1913			
Russia	4918	123,000	123,000
USA	31,800	146,000	146,000

Source: (Gregory and Stuart, p. 26-27)

The Soviet Union brought with it a push for industrialization, and new factories were built in 1926 alone to facilitate the country's growth. However, these factories were built inefficiently. Overstaffed, inflexible to demand, and operated solely on government plans that only worked in theory, they were also built shoddily [evidence]. Railroads were built to connect the factories to trading centers, but the locations of the factories were usually determined by political planning rather than geographic location of the materials they were refining.

Overall, Russia's economy is rich and varied, with a great potential to make engage in fast-paced economic growth. However, Soviet, and now Russian mismanagement have led to inefficient use of factor inputs, leading to inefficient economic constraint theories.

Russia has never conducted policy in a vacuum. It has continually been in a symbiotic relationship with the states surrounding it. Thus, by examining their economies, analysis of Russia becomes more meaningful. Two regional economies that have gone in different directions are Latvia and Kazakhstan. The former is a Baltic state, which were added relatively late to the Soviet Union. As a result, the country had some time to establish a market economy and become independent before being tied down to Moscow's central plan.

Latvia is a small, geographically and ethnically homogenous country of 2.7 million, located in the extreme North of the Baltic Sea. Because it has been resource-poor throughout most of its existence, Latvia has been forced to rely on its proximity to ice-free Baltic trading ports. As a result, much of its economy depends on trade.

Because it is highly urban (68% of its people live in cities), and due to its geography, it has often been linked with the West, particularly with Western markets such as London, Paris, and Brussels (Gregory and Stuart 438).

It is no wonder then, that as a part of the USSR, Latvia, had one of the highest living standards, as well as the best systems of transportation and incentives for exploring technological advances (438). When the government of the Soviet Union came to a financial and logistical roadblock in to the 1980s, Latvia was one of the first given more financial freedom, thus giving it the ability to begin transitioning to other economic choices. Its transition, as will be seen later, has been much easier than other FSU Republics.

Kazakhstan is on the other end of the spectrum. The 9th largest country in the world, it is mostly landlocked, with the exception of the Caspian Sea. Only 57% of its population lives in urban centers and it is much farther away from luxury goods capitals like those of Europe (Gregory and Stuart 439). However, it, like Russia, has enormous energy and mineral resources. Harboring one of the largest oil reserves on in the region Caspian Sea, the country has over 16.4 billion barrels of oil reserves, enough chemicals and minerals to "export the entire periodic table" according to Soviet scientists (Curtis 3), and large quantities of iron ore, manganese and coal.

The country is also in the middle of well-engrained army routes, including those of Ghengis Khan, and has been subject to Russian military forays since the czarist period. During the 1500s, a tribal, patriarchal structure was established which lasts to this day, one of the reasons the republic had a much harder time than Baltic or even the

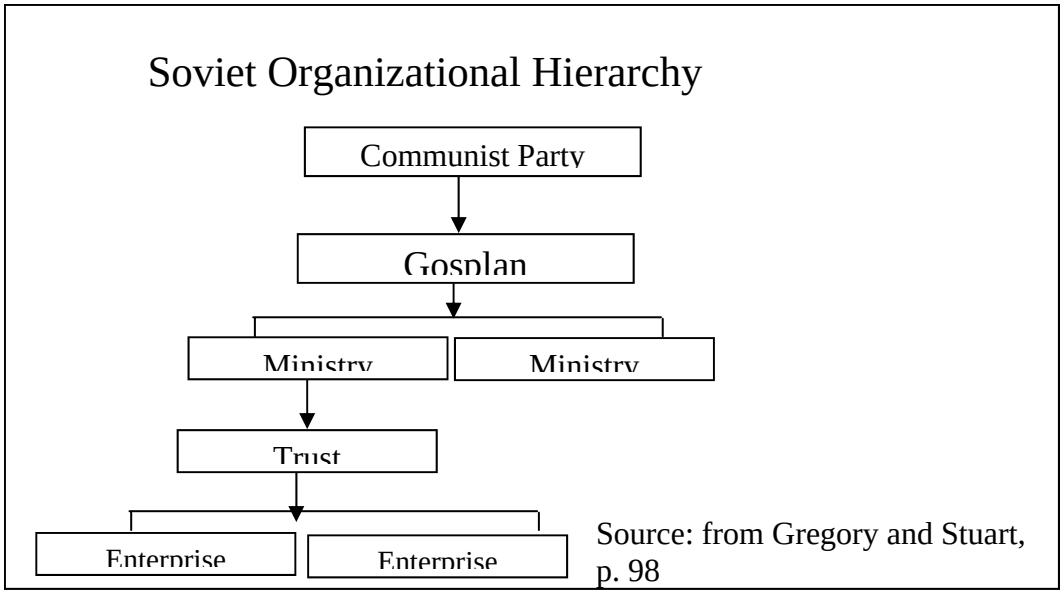
Central Slavic Republics establishing a legitimate democracy government. Though Kazakhstan is just as rich as Russia in natural resources, a number of factors, including years of Soviet, and subsequently, Russian, subjugation, retarded its economic growth.

II. Soviet and Western Economies

Russia at the turn of the 20th century has been described as "a relatively backward country with great economic potential" (Gregory and Stuart 24). The dismantling of the czarist regime and establishment of a highly-structured bureaucratic, planned government caused a radical change to Russia's economy.

When the communists took over in 1917, Russia was still a very rural country, but with much potential to become an industrial economy as was previously noted. However, most of the 1920s and 1930s revolved in setting up the huge bureaucracy that would run the country (See Fig 4). During Stalin's takeover, the country became even more dictatorial through his direction. He advocated avoiding any individual economic initiative, constantly striving to over- fulfill the economic plans established, and cheating to achieve goals (Lavigne 22).

Fig. 4



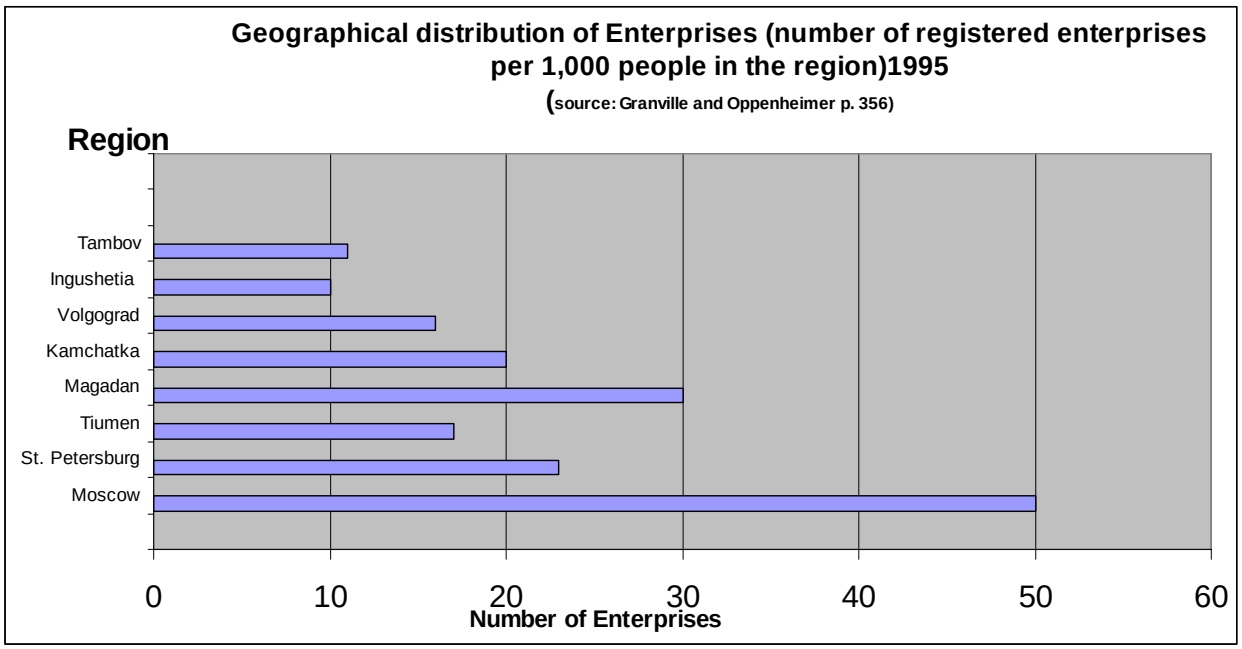
Source: from Gregory and Stuart, p. 98

This structure, as well as cronyism, corruption, and inefficiency, became entrenched within the national psyche, even after Stalin's death and affected all sectors of the Soviet economy. Of particular interest in this paper are labor and capital, and trade.

Although the idea of an economy completely planned and regulated according to man's will is appealing, the practically was far from the ideal. As Easterly and Fisher write, "Soviet growth from 1960-1989 was the worst in the world after we control for investment and human capital; the relative performance worsens over time (371)."

The socialist economy, notes McKinnon, was a monopoly power where industrial concentration, not consumer goods, was the major concern (162). Several other important characteristics of socialist economies include: 1) property rights exclusively held by the state; 2) decisions made using a planning mechanism and conducted centrally; and 3) a reliance on moral rather than material incentives (Gregory and Stuart 198). The industry was organized through an elaborate network of factories, with the main unit of production being the "enterprise", headed by a level of managers and chiefs (Gregory 121). Usually these factories were enormous in nature and specialized in industrial goods. They were also located at locations that were strategic politically, such as Moscow and St. Petersburg (See Fig. 5).

Fig. 5



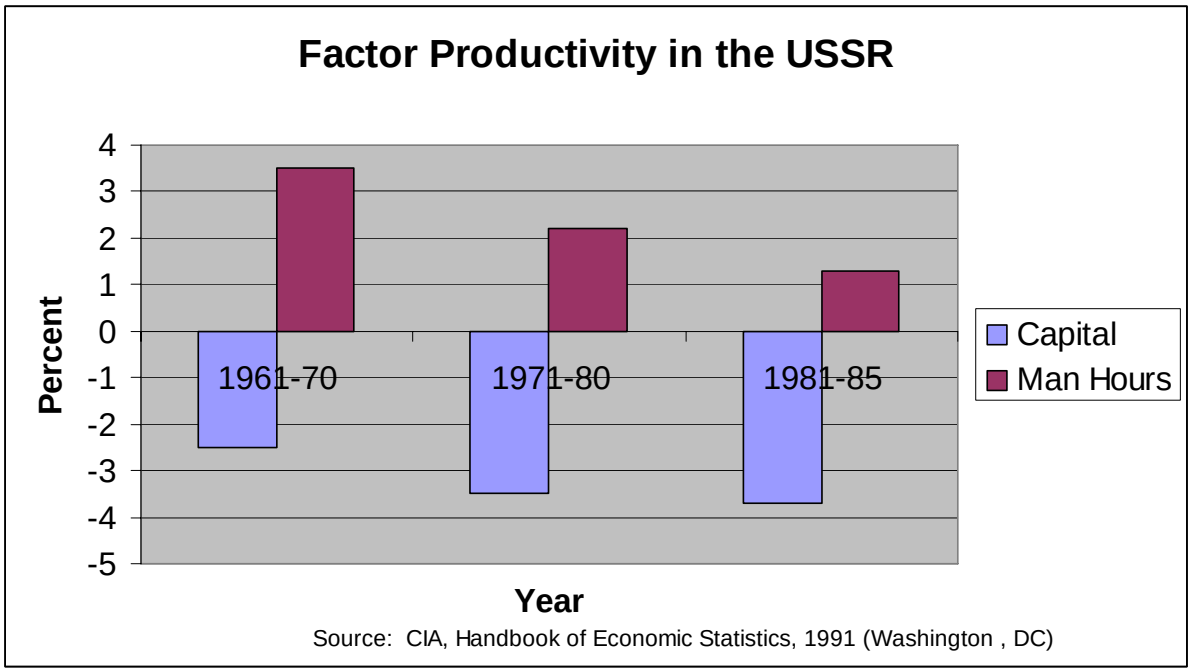
For example, the Industrial Association in Voroshilovgrad produced diesel locomotives, and produced them well. It was the only factory in the Soviet Union authorized to make such products (McKinnon 163).

Managers of these factories would receive planning targets from the government in Moscow. The plans were based on a five-year master plan, broken down into sub-plans by product type and time period. These targets were based combinations of enterprise capacity, expected resource usage, and estimated increases in productivity, all which were often grossly estimated. The economy was constantly overheated, partially due to the fact that the Soviet Union was closed off to trade and could not get all products demanded by consumers, partially because the government implemented

a currency system based on rigid calculations rather than real scenarios, managers never received the exact amount of materials they needed.

As a result, their enterprises consistently underperformed (see Fig. 6).

Fig. 6



However, given even optimal conditions, managers had no incentive to outperform targets because even loftier goals would be given to them by their bosses, until they were incapable of keeping up production pace. It is no wonder then that Soviet capital consistently missed targets.

Aside from problems with capital, the Soviet Union also had a huge problem allocating and caring for its human labor. The biggest problem stemmed from the fact that Soviet workers were treated merely as inputs that could constantly perform at a certain level, and not as people that had irregular productivity schedules.

Another problem was the lack of incentives; salaries were capped at specific levels so over-performing for both factory workers or doctors , just as with enterprise managers, was not rewarded financially, but "morally" with verbal acknowledgments or awards. As previously mentioned, workers mostly occupied the USSR's large, capital-intense industrial sector, with favored professions including engineers, mathematicians, and scientists (Granville and Oppehnheimer 14.) Labor allocation to these fields was a complex process that combined methods of organized recruitment, an internal passport system, and cities that were closed to certain professions or nationalities in order to shift labor from region to region and sector to sector (Gregory 129).

However, despite these theoretical constraints on labor, Gregory and Kohlhase write that this sector was more akin to a capitalist economy than other parts of the Soviet economy (23). Empirical evidence shows that Soviet adults were free to pick almost any profession and that features like reclassification opportunities gave managers flexibility with their workers (23-24). Even so, due to the highly capital-intensive nature of the Soviet economy, 42% of total able workers were consistently employed in industry and construction from the years of 1980-1990 (da Cunha 183). In both cases, the presence of workers during the Soviet Era had no relation to the enterprise's actual production because of inefficient allocation (Curtis 10).

Worker frustration resulted from the fact that the economy of the USSR operated like a machine, churning out only military and energy goods and very few consumer goods, which were regarded and frivolous and unnecessary. The government's

reaction to consumer problems was also extremely frustrating. The answer to excess demand was to ration coupons, requiring many to stand in the long lines that were particularly characteristic towards the end of the 1980s.

A third problem that was a large burden to the Soviet Union's idealistic existence was the concept of trade. The problem was that the Soviet Union and, more specifically, the Ministry of Foreign Trade responsible for such transactions, did not believe in it. Trade, like other sectors, was planned by a state trade monopoly that went by the theory of "less is best," and "Less trade with the West is even better. It was argued that increased Soviet isolation would help to curb inflation and unemployment, as well as other unsavory Western influences such as pop music (Gregory and Stuart 180). This was extremely detrimental because, as a World Bank study notes, "Even in a large economy such as Russia's, exports are a key to rapid growth (da Cunha 20)." Even when trade was conducted, there were extreme barriers to free trade.

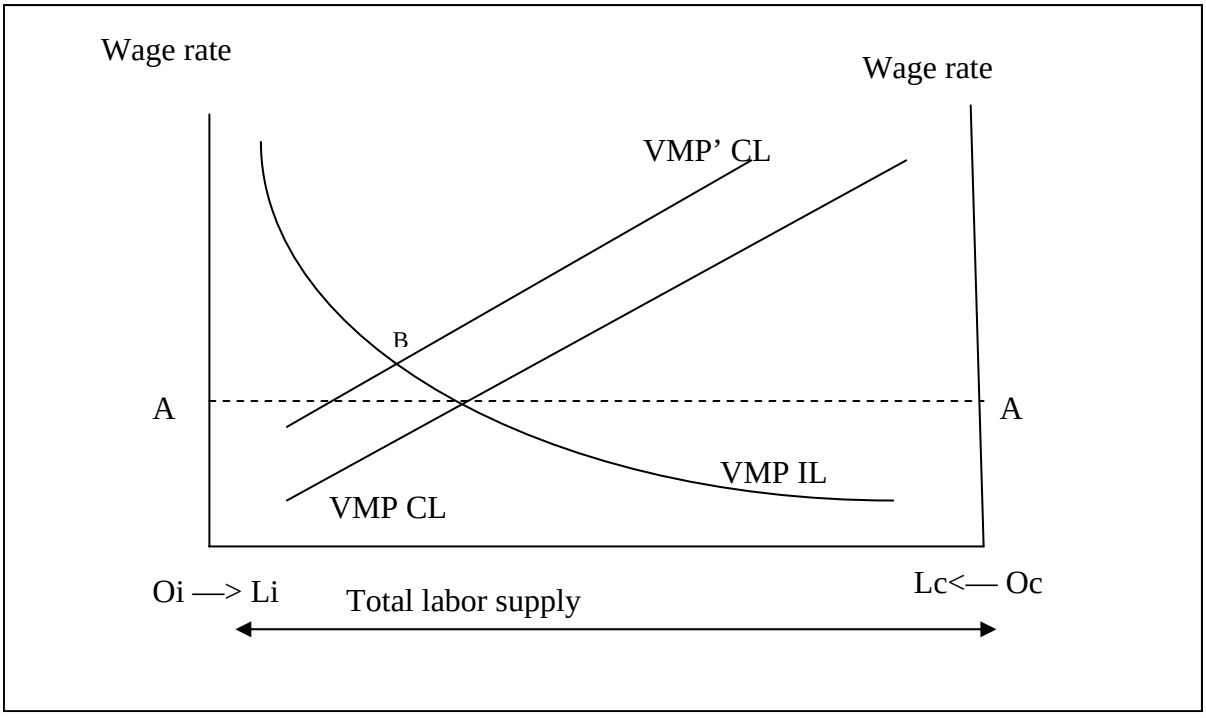
The first was a lack of a stable monetary system with which the Soviet Union could conduct trade. Since there were no interest rates in the Soviet Union and the ruble was artificially set by the central trade committee and the foreign trade bank to whichever price the Central Bank willed it, the Soviet Union did not provide an attractive trade currency to trading partners in the West. The ruble was used mostly as an accounting tool and had little relation to real rubles, meaning at times it was drastically undervalued or overvalued (Gregory and Stuart 179).

The second trade problem was that not only did the government discourage exports, but imports were also shunned. By making trade centrally managed, the

Soviet bureaucracy erected non-tariff barriers to imports because "rationing authorities typically protect import-competing industries through their allocation decisions and because less foreign exchange is available for the market, driving up the exchange rate (Michalopoulos and Tarr 3).

How does the analysis of the Soviet economy figure into economic models of trade? The speficic factors model can serves a guide. The definition of the specific factors model is based on the Ricardian model and has several assumptions, including an emphasis on the difference in factor endowments, a focus on different sectors using different factors, and deemphasizing the difference in technologies and tastes (Caves, Frankel, and Jones 80). This approximates the state of the Soviet Union in that, as discussed, factor endowments play a great role in determining what the country produces. Because the Soviet Union did not focus on developing and improving technology, this is an important aspect to keep in mind when constructing the model (Fig. 7).

Fig. 7



The model above depicts the specific factors graph for a country open to trade and operating under a free market. The inputs are assumed to be industrial labor (I) and human capital (C). This model assumes several things:

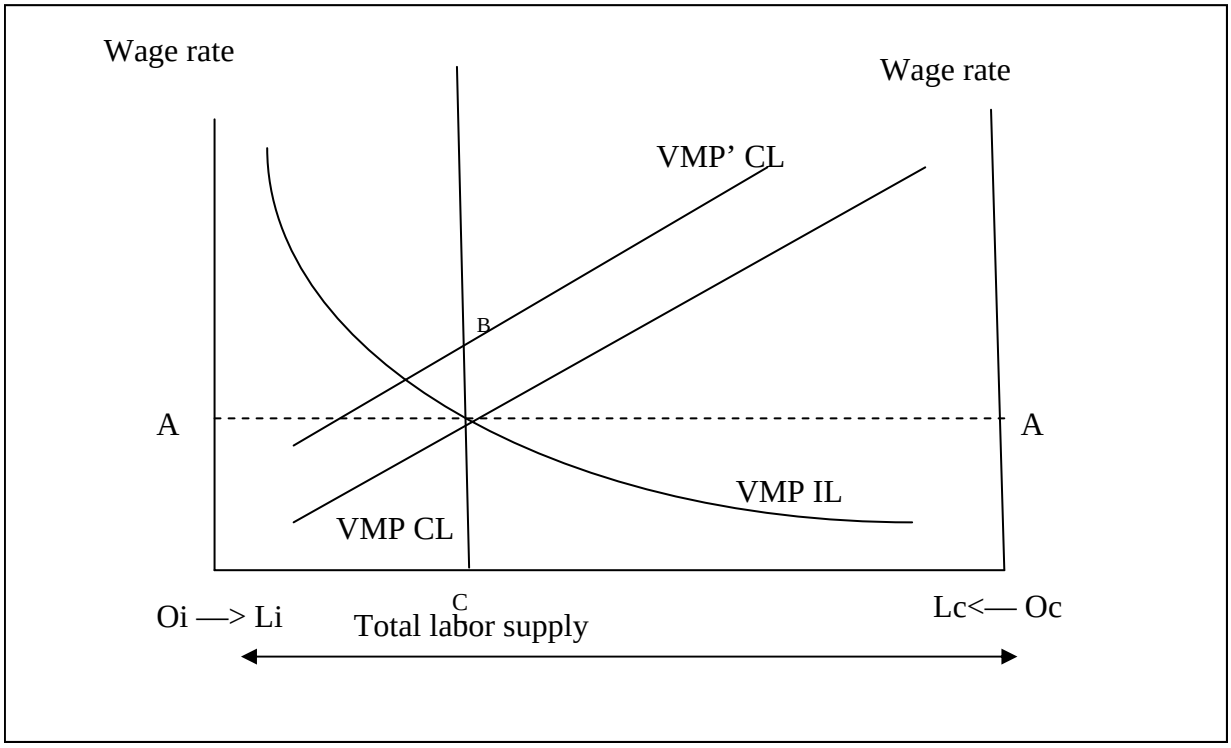
1) Labor is mobile from one sector to another, as shown by the total labor supply line, indicating that labor can be "converted" from industrial labor (assume we're producing tanks) to producing human capital (assume we're producing scientific papers).

2) When this country enters the world market, trade is unregulated, and university heads, which regulate the human capital sector, are happy because human capital, which is relatively more expensive to produce and therefore pays more wages. More workers reallocate to this sector, increasing the marginal physical product of capital, as well as the return to capital (VMP' CL).

3) We assume that owners of industrial labor machinery lose out, and that workers who make tanks can relocate to the human capital sector, raising the prices tank makers are willing to pay workers, which makes those that remain in the field better off (point B on the graph).

The summary of this exercise is to show that in a free market, some sectors win and some sectors lose, but most can adjust their losses to function relatively well. This is different for the Soviet market (Fig. 8):

Fig. 8



For a Soviet producer located in Russia, we assume he opens to trade within the Soviet republics since trade with the West was minimal. Let's say that it is now possible to trade tanks and scientists with Kazakhstan.

Here, labor cannot be reallocated with the same ease as in the West. It is true that Soviet labor reallocation did take place when central authorities used incentives and wage differentials to transfer people from the more populous part of European Russia to factories established in Siberia for political purposes. But, it was not the same process as organic labor reallocation in capitalist countries.

Therefore, the total labor supply is fixed at point C and cannot relocate to a sector more profitable. This results in a wage gap between B and the labor supply line, A. Although this would normally be a signal for people to change sectors, in a fixed

economy wages would not be reallocated and citizens' standard of living would decrease. The extra money garnered by the university administrators would go back into the system, which most likely would not have planned for it and would have to reallocate it through accounting, adding to inefficiencies. The specific factors model for the Soviet Union shows that its markets don't adjust, adding to the problems of the system.

Moscow's dictatorial economy was a far cry from Washington DC's lasseiz-faire one. The largest differences between the Soviet and American economy were ones that resulted in the complication of traditional trade models such as the specific factors model and property rights, The capitalist economy, on the other hand, is based on A closer comparison between the Russian economy and the American economy in the 1960s-1970s, the heyday of the Soviet Union, shows us.

In its essence, capitalism is the free market guided by Adam Smith's allegorical "invisible hand." Investment decisions are guided by a cost-benefit framework where input costs are compared to output costs. Relative prices reflect trade scarcities, thus regulating excessive trade of resources. Most importantly, perhaps, decision-making is made privately and hinges on the fact that some decisions carry risk, while others carry rewards. This is not to say capitalism is not without its problems, which include monopolies, problems of symmetric information, and economic instability (Gregory and Stuart 187). However, all of these problems were found in the Soviet Union, along with the standard problems of socialist economies, so it is hard to say that the flaws in capitalism are worse than the flaws in socialism.

Overall, the Soviet economy was inefficient, as if frozen. In trying to control everything it ended up controlling nothing and becoming too burdened by the levels of bureaucracy and limitations that it created for itself.

III. Liberalization and FSU Trade Policies

It is obvious that such a system could not last. As the Soviet Union fell apart in 1991, a new economic and political landscape began to take shape. Russia emerged as the new regional power, surrounded by 14 independent nations. Factors of production and trade began to take different forms

These changes were dramatic and affected Russian infrastructure much as a fire does an ice cube: by melting down the old structure and creating something new out of old matter, but not quite solid. As Gregory and Stuart note, there are three specific components of transition: microeconomics, macroeconomics, and international trade (12). The focus here, as before, is on examining trade and factors of production, such as human capital, industrial factors, and monetary capital, after the fall of the Soviet Union.

Russia's experiments in liberalization began rather haphazardly, with all institutions being dismantled before a solid capitalist foundation was in place. This process had already begun in the late 1980s, but Gorbachev merely tried to reform the Soviet structure instead of instituting something completely new, resulting in declines in output even before price liberalization and other market reforms occurred after the fall of the Soviet Union. This resulted in losses of production in almost all industries.

"The state of the economy at the end of 1991 could hardly have been worse, " noted the World Bank Commission (da Cunha 17).

Reforms in the capital sector began slowly but showed encouraging signs. Between October of 1992 and July of 1994, for example, over 100,000 state enterprises had been privatized (Gregory and Stuart 301-2). It is true that after 1991, enterprises could determine what and when to produce, unhampered by state planning. They also now had the ability to allocate profits into whichever sector they desired (da Cunha 83). Although this was a step in the right direction for free markets, it decreased central government revenue. Local governments begun to play a larger role in enterprise ownership; however, their lack of knowledge about capitalist business tactics (a byproduct of Soviet strictly technical education) continued the muddle over what exactly they should be doing and was also a hindrance to capital performance and to the Russian economy as a whole.

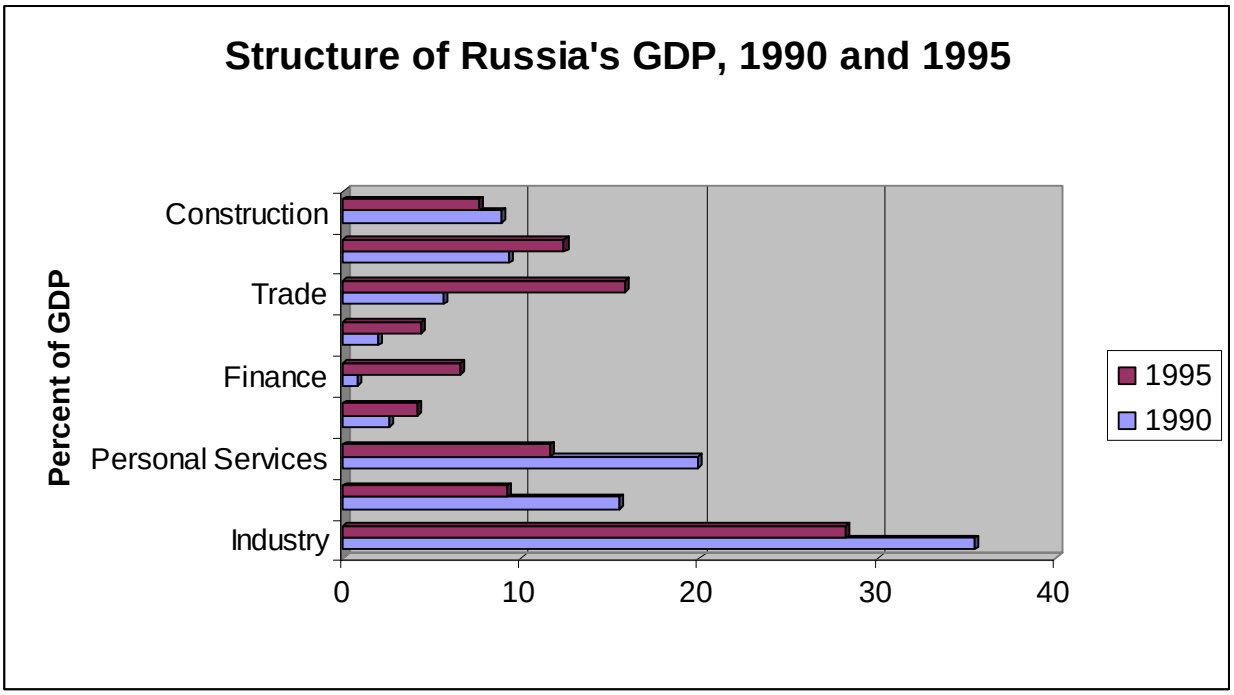
Although the structure of the Russian economy had shifted to non-government ownership by 1995, currently, Russian industry is mostly made of large, near-monopolistic enterprises, such as oil companies, energy companies, and defense contractors. For example, the Kremlin currently still dictates the amount of oil that passes through Russia's pipelines (Gregory and Stuart 205).

However, after the fall of the Soviet Union, a significant restructuring effort began in this sector, especially since the delivery many inputs that used to come from former Soviet republics ,such as coal from Kazakh mines, became unreliable as trade conditions deteriorated during 1991. As it stands, many enterprises are still not

competitive by international standards because of the residue of Soviet planning. They are "overstaffed, and are much more energy-intensive than foreign competitors" (Michalopoulos and Tarr 48), meaning they have much more progress to make.

A shift has also occurred in the capital sector in that Russia has begun producing consumer goods instead of the heavy, capital-intensive military and energy installations the Soviet Union prided itself on. Increases can be seen in the growth of financial services, personal services, and international trade. Industry declined to 28.8% of Russia's total GDP from 1990 to 1995, and transportation and communications share grew by over 3% (Gregory and Stuart 334) (See Fig. 9).

Fig. 9



The jury is still out on whether conditions in the labor market have improved. Initially, in the Soviet Union, state socialism provided an employment safety net, as well as labor allocation net as a guarantee to the employee that was fired. Workers could count on benefits, regardless of demand for labor, or, more importantly, their productivity (da Cunha 141). It is surprising, then, that unemployment did not occur as drastically as expected in 1991. However, as Lavigne notes, this was not a positive trend because it means enterprise managers did not release workers due to economic conditions (150), a fact that shows how prevalent the Soviet mentality truly was. In fact, half of plant directors surveyed in 1995 revealed that they had more workers than was necessary (Curtis 10). In 1997, unemployment caught up and grew to about 11% in Russia.

The biggest concern with labor in Russia is creating a "safety net," or a series of measures designed to reduce negative externalities for the unemployed, as well as to protect minimum standards of living. This system, fully functional in the Soviet Union, has not yet been completely established in Russia. Overall, it is important to note that the Soviet system produced a well-educated and capital-oriented labor force. The only problem left to overcome is the social safety net and other financial implications of transition.

The trade situation began to improve, but only gradually. Given previous Soviet policies, Russia was an extremely isolated, except for a few cases of joint ventures

between Soviet and Western firms in 1986, and the 14 remaining independent states were helplessly tied to Moscow's policy, when reform in international trade began. Initially, the breakup of the Former Soviet Union interrupted interstate trade to an enormous extent (Michalopoulos and Tarr 44). Goskomstat data indicate a drop of as much as 29% in exports and 46% of imports with other former Soviet republics (de Cunha 15). As McKinnon noted, "A sustainable movement toward free foreign trade in goods and services is crucial for successful transition from socialist to market economy (162)." During the 1990-1993 period, collective trade in the 15 newly-independent states fell by as much as 60% (2). This was due in part to the fact that the foreign exchange market essentially needed to be created from scratch.

Two things especially hindered Russia's progress. These included the establishment of a vital foreign currency and lifting of trade barriers. The Soviet Union did not have a fixed currency. The ruble was complicated and separated into two parts: one for everyday use, and one merely for accounting value. Both were calculated theoretically, not according to relative prices or demand. The ruble used for accounting value (*valuta*) was the one exported abroad, also not reflecting comparative advantage and true prices, but on a global scale. Therefore, when free trade was established, exchange rates occurred organically.

In 1991, hundreds of individual exchange rates prevailed before the government intervened (McKinnon 178). Setting up a single exchange rate was an arduous task that consisted of setting rubles to dollars according to the purchasing power parity principle, which took into account domestic wages and domestic, as well as foreign outputs (179).

This was accomplished in 1991 by the Currency Exchange Law, which authorized currency exchanges and undermined the central bank monopoly (Gregory 389). The exchange rate began to stabilize around 1993. It is interesting to note that throughout the transition, the Russia economy had a positive balance on the trade account, selling more goods and services than it purchased (Gregory and Stuart 344).

However, free trade did not mean a free-for-all for the Kremlin. Initially, the state continued to control imports and exports through measures such as export taxes, quotas, licenses, and other extraordinary measures to regulate exports (Gregory 394). Regulation has been decreasing: the tariff schedule has been changed at least 3 times since mid-1992, and the government is finding that it is playing an increasingly smaller role in trade determination (Michalopoulos and Tarr 41).

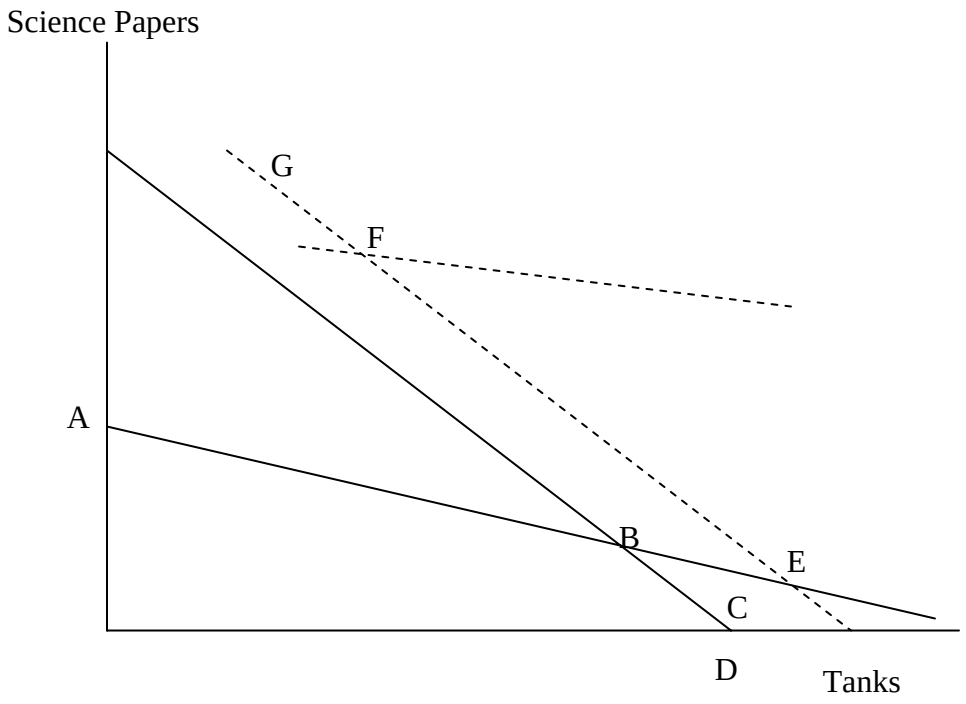
Just as the specific factors model can be used to analyze some of the inefficiencies of the Soviet economy, the Heckscher-Ohlin model can be used to analyze trade in a post-Soviet framework. Basic tenets of the Heckscher-Ohlin model emphasize the difference in factor endowments, and the relationship between factor rewards and trade, especially pertinent to examining the new independent Russian economy (Caves, Frankel, and Jones 99.) The model shows which factors are relatively abundant, what happens when a country shifts from autarky to free trade, and how free trade equalizes factor returns.

Assume that America and Russia are now engaged in trade, and, having torn down the Iron Curtain, are trading scientists and tanks. America specializes in scientists, and Russia specializes in tanks. This is based on concrete evidence that says

Russia is still a capital-intensive country and as much as ¾ of its exports include its top 3 or 4 commodities: oil, coal, iron ore, and military parts (though the export of military parts has been declining since the bankruptcy of the Soviet Army.)

The resulting figure would look like this (Fig. 10):

Fig. 10



Assuming that the home country is Russia and the foreign country is America, this shows us their equilibriums for trade. This model also now assumes that both sectors can produce both factors with both types of outputs in intensity. That is, human capital goes into both science papers and tanks, and industrial capital goes into both science papers and tanks as well. Locus *ABD* would indicate Russia's production possibilities curve, and the dotted locus *AEC* represents America; that is, with the same

human and industrial capital, but twice the population (300 million vs. 143 million, which is almost exactly accurate.)

Given a larger population that is working, Russia could also theoretically produce at locus AEC, a more attractive production point. It could also reach this point through technology growth. However, since technology is fixed in this case (as it is in real life, where detachment from the Soviet system has hindered it in the pursuit of new technological reforms.) This graph proves that, "The relatively labor-abundant home country will tend to export the relatively labor-intensive commodity (Caves, Frankel, and Jones 98)." Thus, Russia will export tanks. Just as today, it exports capital-intensive goods such as oil, energy requirements, and car parts. This model provides for a good graphical representation of why Russia trades the way it does after an open economy.

Russia has been shakily on the road to recovery, but it was not independent of events going on in the newly-liberated republics. Russia's move had influenced the former USSR states to lower exports as well, causing exports to the rest of the world in 1991 to decline by 70.2 billion, a decline of 32% from the previous year (da Cunha 121). Each handled liberalization differently.

Latvia is a textbook case of liberalization headed in the right direction. The best of the republics during the Soviet era, it also one of the first to start liberalization quickly and competently. Breaking away from Russia left it with no natural resources, cutting off as much as 15% of Latvia's GDP (Michalopoulos and Tarr 16). But, Latvia relied on its position as a small European country oriented at the crossroads of trade to

quickly introduce monetary reform and to privatize after developing its own institutions independent from Soviet implants. A new currency was introduced in 1992, and exports to non-European countries increased that year (3). It established a Baltic Free trade area to help process more industrial goods. Though initially it had declining output, after 1994, Latvia experienced only accelerating growth (Gregory 341), and its transition was successful after 2-3 years.

Kazakhstan, on the other hand, had a harder time adjusting to the free market. Just as the Baltic states moved quickly to establish capitalist markets, Kazakhstan and other Central Asian states reverted to what they knew best: "a network of massive intergovernmental barter agreements, with goods to be distributed through state ministries of material resources (Michalopoulos and Tarr 17)." Although Kazakhstan started out well with a wealth of natural resources, following independence, problems arose with the availability of equipment and pipes used to export oil. Transportation constraints play a huge problem in the inability of the country to rise above the lowered terms of trade exerted by Russia.

The other problem lies in Kazakhstan's inherent form of government. After the Soviet Union, it went back to a patriarchal, clan-based government which slowed the economy. It is currently attempting to convert its economy to one that is more based on democratic rule and a greater independence of Russian policy. To this effect, it has actively encouraged ethnic Russian families that had arrived in the 1930s under the Virgin Lands program to leave, instituted a trading block with the other Asiatic

republics of Uzbekistan, Turkmenistan, and Tajikistan, and began marketing its natural resources to lure investors.

Liberalization and the fall of the Soviet bloc was a huge blow to all three countries: Russia, Latvia, and Kazakhstan alike. Because of the huge complexity of the Soviet economy, Russia has had some difficulty dealing with capital and labor issues, and Kazakhstan and Latvia have had to find their own (different) ways to free trade, Western economies.

Conclusion:

Russia has always been a big country, both in size and in the amount of interest and influence it has evoked in political and economic trade circles. Although it started in the right direction during the czarist era, beginning to industrialize and possessing much economic potential, communism froze its budding economy. Other countries in the region, including Latvia and Kazakhstan, were equally affected by the Marxist economic revolution. The various inefficiencies of the Soviet system, in capital allocation, labor allocation, and international trade, eventually caused enough pressure for Russia's isolationist ice cube to crack and melt. Currently, it is hard to predict whether Russia has fully made the transformation to a Western, democratic and capitalist economy, but, as always Russia will evoke enough speculation for future generations to study it.

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