

Juliet Johnson, *A Fistful of Dollars: The Rise and Fall of the Russian Banking System* (Cornell University Press, 2000)

In the textbook model of a well-functioning market economy an independent central bank controls the supply of high-powered money and regulates broad credit creation so as to promote price stability or low, stable inflation. On the monetary base provided by the central bank commercial banks create credit; they build a complex edifice of deposits and loans that allows depositors to keep their wealth in forms that are liquid and accessible, while borrowers are enabled to make long-term investments in real assets. As a result everyone is left better off and economic development is also promoted. This combination involves risks: a borrower's investment may fail, while a depositor may wish to withdraw cash. Banks allow the risks involved to be spread among many borrowers and depositors. Moral hazards confront both bankers and borrowers, both of whom can run off with depositors' assets; these are normally dealt with by a mixture of insurance and central-bank regulation.

But Russia is not a normal or well-functioning market economy. Juliet Johnson's excellent study examines Russian banking in the ten years from Gorbachev's first steps towards liberalisation to the Russian financial collapse of 1998. It is based on extensive documentation and interviews with bankers and business people in Moscow, Volgograd, and Riazan'. It presents a series of object lessons in unintended consequences. Russian commercial banking emerged at the end of the Soviet era through the loopholes of the legalisation of independent "cooperatives" under Gorbachev. They played an essential role in the insider privatisation of state assets whereby the Soviet *nomenklatura* launched itself into the new world of market transition. But in this new world banking completely failed to play the roles designed for it by western transition economists. An independent central bank fuelled inflation until brought under control by the government, which was meanwhile contributing to inflation on its own account. Commercial banks promoted rent-seeking, corruption, and criminality. Some banks were no more than shells for lobbying or laundering money. Other banks accepted deposits, then appropriated their depositors' wealth by capturing inflation profits or more directly by misappropriation. The credit that yet other banks created went into borrowers' pockets or to pay for the government's fiscal deficit. As commercial banks became increasingly important to public finance and increasingly divorced from production, the conditions were established for the financial collapse of August 1998. As a result, the Russian public remains rationally distrustful of bank-based transactions, and the associated low level of financial intermediation will continue to be one of a number of factors restricting the scope for investors to begin the economic recovery process.

Johnson's main finding is that the design of Russia's transition to a market economy failed to pay attention to the institutional underpinnings that make market arrangements effective elsewhere. A growing consensus supports this view which should no longer be considered new or controversial. However, a particularly interesting aspect of Johnson's account is her discussion of the relationship between markets, economic development, and democracy. Among the institutions necessary for market-based economic development she includes not only strong and enforceable property rights but also democratic accountability: "Liberalizing economic policies carried out in politically authoritarian ways did not and can not yield their intended results, because Russian leaders and international financial institutions have misconstrued the fundamental nature of the Russian transformation. Marketization advocates in Russia and the West mistakenly thought they were fighting the twentieth-century battle of the budget, when they were actually fighting a nineteenth-century battle of state-building" (p. 231). A decade of western aid and advice has left Russia with stunted democratic institutions and billions of dollars of debt, but without effective encouragement for industry and banking. Thus if Putin is

building not a “strong” state but only a “strong-armed” state, Johnson’s expectation is that Russian investors’ calculations will remain dominated by uncertainty and short-termism and banks that promote market-led economic development will not emerge.

*A Fistful of Rubles* will be welcomed by students of Russia, transition economics, and banking and finance, and should be compulsory reading for central bankers.

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