In need of economic cure, Soviets choke on 'free market' poison

by Rachel Douglas

On Sept. 24, after passage of the U.S.S.R. Supreme Soviet resolution "On urgent measures to stabilize the national economy and the program of transition to a market economy," German Chancellor Helmut Kohl welcomed the vote, saying that "the decision for the market economy creates the right preconditions for Western economic aid."

Anybody who has understood that economic development is the basis for war-avoidance must hope for the transformation of the Soviet Russian empire, ultimately, into a constellation of prospering, sovereign nation-states, and, in the short term, for investment from newly reunified Germany to help prevent the empire's collapse from exploding into civil war. The question is how the Soviets can receive and assimilate such Western input. In its current state of breakdown, the Soviet economy has a horrific record of annihilating foreign goods without a trace: As much as one-third of the DM220 million worth of food aid, arranged by Kohl for the Soviets in February, had failed to reach consumers as of June, due to lack of transportation. In industry, a November 1989 government inventory of imported equipment found millions of dollars worth of light industry, food-processing, and metal-cutting equipment that had never been put to use, much of which had been sitting in warehouses or at open-air depots since before 1983.

Friedrich List vs. Adam Smith

Just as in Germany itself, and in Poland and Czechoslovakia, the fight for successful economic reform in the wake of the Bolshevik devastation of the Soviet Union can be posed as a contest of "List vs. Smith." Will the formerly communist countries exchange one failed doctrine for another, by swallowing the prescriptions of free marketeers who trace themselves from Adam Smith, author of *The Wealth of Nations* and propagandist for the British East India Company? Or, can they adopt the nation-building methods of Friedrich List's *Outlines of National Economy* and other works?

The draft of a modern Listian, "American System" solution is circulating in Eastern Europe today. It is Lyndon LaRouche's concept of the economic development of Eastern Europe, as far as the Ural Mountains, along growth corridors, spiraling out from a hub of intense industrial and scientific work in the Paris-Berlin-Vienna triangle.

Inside the Soviet Union, individual voices have been raised in favor of a Listian revival. In July, the Soviet Foreign Ministry's journal carried one writer's appeal to reflect on the wisdom of a strong Russian relationship with Germany, advocated in the late 19th century by Count Sergei Witte (whose economic advisers were close students of List). Others have cited the importance of the 1906 agrarian reform of Prime Minister Pyotr Stolypin, who fostered the formation of small, independent farms in Russia.

At the state leadership level, however, the Soviet economic policy fight has been nearly devoid of such promising ideas. The Sept. 24 Supreme Soviet resolution, welcomed by Kohl, was no decision. It set a deadline of Oct. 15, for President Mikhail Gorbachov to present the "transition to market" plan by reconciliation of proposals that officials frankly admitted were incompatible. The hybrid plan, unveiled by Gorbachov a day late and approved by the Supreme Soviet on Oct. 19, portends more stormy confrontations in the immediate future.

In the meantime, chaos reigns. Speaking at the Sept. 17 Supreme Soviet session, although negotiations were almost complete for a new 20-year Soviet-German economic cooperation agreement to be initialed Sept. 28, economist Abel Aganbegyan reported, "Because of the hold-up in credits provided by Western banks, we are threatened with a 20% reduction in the volume of production next year. Just because of this factor we can be put back five to seven years, as far as levels of output are concerned, with general disorganization of the whole economy. *Credits are not being granted because there is no unity in the country; it is not known to whom to give them!*"

The '500 Days'

At the center of the Supreme Soviet battle over the "transition to the market" was a recipe known as the 500 Days plan or, since late summer, the Shatalin Plan. It was drafted chiefly by economists attached to the government of the largest Soviet republic, the Russian Republic (R.S.F.S.R.), whose President is Boris Yeltsin.

This scheme is not what the Supreme Soviet has approved as of Oct. 19, but the Shatalin Plan's stature as the most radical option has contaminated the entire Soviet debate on economic policy. With it as the reference point, all other proposals were constantly assessed as being closer or further away from the Shatalin group's vision of what makes for a "market."

The Shatalin Plan, as outlined in the Soviet press and circulated in draft, is unadulterated monetarist hocus-pocus.

Back in June, Yeltsin-supporter Mikhail Bocharov of the Interregional Group of deputies in the Supreme Soviet outlined an earlier version—President Yeltsin's 500-day plan for the Russian Republic, which had just asserted its "sovereignty" with respect to economic and other policy areas. It would comprise four phases: preparation, privatization, introduction of a market, and stabilization. The first would be a 100-day period of publicizing the plan, taking inventory, and warning economic enterprises that their subsidies were about to be terminated. During the five-month second phase, the equivalent of $320 billion worth of government-owned industry would be sold off through share issues and other means. In the next period, to create a "market," prices would be decontrolled. Heavy industry production would be expected to plummet. The last 100 days would entail targeted government investment to resolve remaining "structural problems," and the reduction of prices on consumer goods. Subsequent refinement of the plan, including by the Shatalin group, preserved these main elements.

An executive summary of the Shatalin Plan, carried in *Izvestia* Sept. 4 under the headline, "Man, freedom, market," laid bare more of the scheme.

As a fundamental principle of the reform, the Shatalin group asserted something that presumes a radical transformation of the Russian ideology, the state of mind of average people after centuries of oppression: In this reform, "people should not wait for somebody's permission or orders, but should act in accordance with their interests. . . . Nobody imposes on anybody else his type of activity; each is free to choose, guided by his wishes and capabilities: to become an entrepreneur, a hired worker in the state structures, or a manager at a joint-stock company, or to engage in individual labor activity or become a cooperative member. The reform offers people the right to economic self-determination. . . . Precisely the freedom of choice is the basis of the personal freedom of people, the basis for bringing out the creative potential of the individual."

An American reading this might think he were being served up a plate of advice from Milton Friedman's *Free to Choose*, but what is the Soviet peasant, or urban worker who spends half his time scavenging for food, supposed to make of it? Perhaps the only echo in the Soviet period would be Nikolai Bukharin's ill-fated exhortation to the peasantry in 1925: "Enrich yourselves, accumulate, develop your economy." Peasants who did well were slaughtered by the millions a decade later, and Bukharin was executed in 1938.

"Forward—to the market!" says the billboard, in this cartoon from the front page of Izvestia, *Aug. 20, 1990.*

When the Soviet regime moves "to take everything possible from the state and give it to the people," according to the Shatalin draft, everybody is supposed to get the same chance. "Almost anyone, even somebody having no initial capital of any size, will be able, if he wishes, to get his share of the national wealth. The equality of opportunity will be ensured by the diversity of forms of privatization, which will give the possibility either to lease property, or buy it on credit, or obtain it on a share basis, etc." Of course, the state can't give away property for free; it will have to be earned. But some items will be deemed already earned, and therefore granted free or for a nominal fee—small garden plots, or small apartments occupied for a long time.

Immediately after the first wave of privatization, "work should begin on creating . . . 50 to 60 joint-stock companies, on the basis of major state enterprises." Inventory should be taken of all the national wealth of the country, starting with gold and financial reserves, strategic reserves, property of public organizations, unfinished construction projects, property of the Armed Forces, and other state property. The inventory of the unfinished construction will set the stage for these piles of unexploited materials to be transferred to the population, to individuals and cooperatives.

The draft included legalization of much black market activity. With the privatization of small enterprises and the conversion of big ones to joint-stock companies, also "amnesty is declared for those convicted under the articles [of the Criminal Code] on entrepreneurial activity," which made it a crime to profit from the sale of the fruits of others' labor.

Peasants in the village of Ozero, Nizhnegorod Oblast, wait for bread at their rural store. The economy is in a state of utter breakdown, for which "free market" schemes are no cure.

The Shatalin group would "normalize the consumer market" through "the liberalization of price formation." During the transitional period, it would use "the formation of commodity reserves, including through imported supplies," and freeze prices on some staples so as to avoid drastic inflation. There will be free trade of currency, banks can carry out currency operations, and citizens can keep hard currency in their bank accounts.

Under "the right of citizens to the growth of income and social guarantees," the Shatalin group forecast monetarist forms of enrichment: "An ever greater role in the composition of the population's income will be played by income from property: getting higher interest rates than now on deposits in banks and government obligations, and getting interest from stock shares."

Not just individuals, but also firms are supposed to acquire "freedom of economic activity." The Shatalin draft suggested that members of a collective, i.e., the work force of an enterprise, could select privatization, becoming a joint-stock company, or some other flavor of ownership. Then they could fire their directors and hire competent ones. After existing economic contracts were unfrozen in July 1991, the enterprises would be able to pick their own product mix, suppliers, customers, and what part of the country they want to market to. While they got a lot of freedom, enterprises would have to consider the new limitations: "higher cost of credit, reduction of budget subsidies to zero, sharp reduction of state capital investment, reduction of state purchases, foreign competition."

Bad foreign advice

The authors of the draft summarized above were Stanislav Shatalin, Nikolai Petrakov, G. Yavlinsky, S. Aleksashenko, A. Vavilov, L. Grigoryev, M. Zadornov, V. Martynov, V. Mashchits, A. Mikhailov, Boris Fyodorov, T. Yarygina, and Ye. Yasin—collectively known as the Shatalin group, or the presidential team. The initiative originated last spring, with those of the authors who worked at Yeltsin's government of the Russian Republic.

The March 4 elections in the Russian Republic brought candidates from the non-communist Democratic Russia slates to power in local and regional *soviets* (councils) and the republic's Supreme Soviet. Many of them espoused the late Academician Andrei Sakharov's ideas of personal liberty and social justice, but lacked knowledge of economics.

Knowing that the Soviet planned economy was a disaster, these democrats were vulnerable to the hoax, that a monetarist "free market" approach would be the antidote. Western free marketeers, from Harvard, Wall Street, the City of London, and the International Monetary Fund (IMF), swarmed all over the Russian reformers, just as they have parasitized on every freedom movement in Eastern Europe. The "shock therapy" of plant closings and mass unemployment, prescribed by Harvard's Jeffrey Sachs as adviser to the Mazowiecki government in Poland, is only the most notorious case. In Austria, the International Institute of Applied Systems Analysis (jointly founded by Soviet globalists and McGeorge Bundy of the U.S. Establishment in the late 1960s) is in the midst of one of its biggest projects ever, a comparative study of privatization in economies all over the world. At an Aug. 17 Soviet government session on the reform, this IIASA study was mentioned as something that "must, of course, be used by our country as well."

Boris Fyodorov, the Russian Republic's finance minister and a member of the Shatalin group, is a 31-year-old economist who says he got his reform ideas from studying Great Britain during Margaret Thatcher's rule. "As a young graduate at the Soviet state bank," the *Wall Street Journal* wrote about Fyodorov in July, "part of his job was to monitor Mrs. Thatcher's moves. 'It was a good school. I learned a lot,' he says," adding, " 'I want to create an infrastructure that will enable any three people to get together and form a corporation. . . . The spirit of enterprise should be as free as possible.' He wants to turn Russia into a budding nation of stock owners and private entrepreneurs, legalize the black market in foreign exchange and introduce a new concept into Soviet economics: strict monetary and fiscal discipline. He says 'We can and will use lots of elements from the British economy.' "

Stanislav Shatalin, pleading before the Supreme Soviet for the 500 Days agenda, has acknowledged the role of foreign free market ideologues: "If we want to save our country, we have to believe in this system. It is correct from a professional point of view. *It has really been looked at by people who understand the market economy better than we do*. It is correct."

In June, the British-Soviet Association of Lawyers was formed for the included purpose of helping Soviet lawyers and economists "study the legal infrastructure of a market economy, and market laws," according to *Pravda*. In September, Fyodorov, Yavlinsky, Yasin, and three other Russian Republic members of the Shatalin group were flown to Washington, at the expense of Hungarian-American financier George Soros, to attend the annual conference of the International Monetary Fund.

With such inputs, it is no wonder that the Shatalin Plan sounded like a monetarist think tank's computer printout, and not at all like a program to rescue a nearly dead economy.

Free market by decree?

Modification of the Shatalin Plan took place under the twin pressures of the breakdown of production and distribution of goods throughout the Soviet Union, and the impending breakup of the empire itself. From the beginning, the nature of the economic reform has been linked to the question of who will rule.

Back in April, U.S.S.R. Deputy Prime Minister Leonid Abalkin said that it would take "10 years" to form a market economy in the Soviet Union, since no "social consensus" existed on how to do it. In the intervening months, it became clear that no consensus existed on keeping the Soviet Union in existence for that long, either. Gorbachov and his new Presidential Council, in uneasy parallel with the government of Prime Minister Nikolai Ryzhkov, which still has the task of running the Soviet economy day-to-day, worked under the gun of massive labor unrest, political ferment, and ethnic rebellions against the empire and local enemies. The miners' strike of summer 1989 and labor stoppages at the giant Uralmash machine tool plant in Sverdlovsk at the outset of 1990, served notice that people not only in the "captive nations" republics of the periphery, but in Ukraine and Russia, were rebellious. One after another of the 15 republics declared "sovereignty" or, in the case of Lithuania, attempted to establish outright independence. Non-communist movements swept into the Supreme Soviets of each republic, including Russia.

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With the Communist Party of the Soviet Union losing its clout by the day, Gorbachov struggled to put in place the new presidential system. Yavlinsky and the other Russian Republic economists hitched their 500 Days plan to that wagon. The transition was to a "free market," they said, but it would take presidential rule by a strong hand to carry it out. Only "the high concentration of power and the U.S.S.R. President's prestige [would] make it possible to effect a dynamic comprehensive transition to the market within a short period," *Izvestia* later summarized their views.

In April, Gorbachov said that because the economic crisis brooked no delay, the "market" transformations slated for 1992-93 would have to be carried out this year. But the Presidential Council sessions on what the measures should be were deadlocked, and while scads of Soviet economists publicly warned about the dire necessity and coming brutal impact of a "sharp turn," the schedule for presentation of the relevant legislation, by the government to the Supreme Soviet, was delayed until autumn.

No 'Polish model'

Loose talk about the liberation of prices from state supports fed a furious controversy. Accusations flew about the "Polish model," as a plot to wreck the Soviet economy. Already on March 13, the daily *Sovetskaya Rossiya* (voicing the views of Russian communists, not Yeltsin's team) indicted the measures Jeffrey Sachs had foisted on the Mazowiecki government in Poland, the first non-communist government there in four decades, to introduce "market" relations on a crash basis, starting with the complete deregulation of prices, mass unemployment, and factory closings. "To be honest," jibed author V. Runov, Polish Finance Minister "Balcerowicz's plan could with every justification be given the name of the IMF. . . . The program of reorganization of the Polish economy was created under its pressure and with its direct participation. And the assistance was made directly dependent on the fulfillment of two main conditions—a lowering of the living standard of the working people and a weakening of their social protection. Judging by everything, the West has chosen Poland for the implementation of a large-scale socioeconomic experiment."

The insinuation was that anybody who advocated the same for the Soviet Union was a traitor. The unfettering of prices became the stumbling block for any plan.

The free-marketeers from the Russian Republic, however, cloaked themselves in the garb of moderation in this regard. Yavlinsky's 500 Days draft called for freezing prices on some basic necessities, for part of the transition period, while Prime Minister Ryzhkov's economists were insisting on immediate price hikes on previously subsidized goods. The government's announcement of food price increases for July 1 was denounced as "shock without therapy," and hastily withdrawn in the face of threatened strikes.

Acting through the Interregional Group of deputies in the U.S.S.R. Supreme Soviet, the Russian Republic leaders seized this moment of political failure of the government measures, to push for adoption of the 500 Days schedule for transition to a "free market." Gennadi Filshin, IRG leader and R.S.F.S.R. deputy prime minister, raised a vote of no confidence in Ryzhkov's government.

Post-Shatalin compromise

At the end of July, Gorbachov and Yeltsin commissioned the Shatalin group of economists, answering to them as Presidents of the U.S.S.R. and the R.S.F.S.R., to draft new measures. At the core of the group were Yavlinsky, Fyodorov, and the other whiz kids from the Russian Republic, authors of the early 500 Days drafts. To them were added the two economists from Gorbachov's Presidential Council, Nikolai Petrakov and Stanislav Shatalin. Both are former staffers of the Central Mathematical Economics Institute; both are long-time advocates of deregulation and privatization. Shatalin, according to himself, is also a devotee of astrology.

U.S.S.R. Deputy Prime Minister Leonid Abalkin was announced as a member of the group at the outset, but evidently attended only some of its meetings and did not sign the draft that was circulated in September. He and Ryzhkov, meanwhile, went to work on an alternate package, and on measures to get the Soviet economy through next year.

Reconciling the Shatalin Plan with Ryzhkov's measures would be like mating a hedgehog with a snake, Yeltsin complained, but Gorbachov and the Supreme Soviet assigned Abel Aganbegyan to do just that during September and October. Gorbachov's instruction was to "take the path of removing state control and setting up a mixed economy in which state and joint-stock enterprises, cooperatives, and enterprises operating on leasehold principles—but also, on a certain scale, private enterprises—will operate as subjects with equal rights."

In the hybrid, approved Oct. 19, the 500 Days timetable has disappeared. Many areas are exempted from immediate privatization: Gorbachov told the Supreme Soviet that the defense industry, energy, rail and all other transport, the space program, and telecommunications would remain wholly owned by the state. (This was also provided for by Shatalin's group, which said that the defense industry, a unified power system, the railways, long-distance communications, and the postal service would remain in government hands; but Petrakov had spoken earlier this year of restricting state investment to defense, space, education, health care, and aid to orphans and disabled people.)

The politically sensitive question of privatization of land is deferred, pending a national referendum. The Shatalin Plan had anticipated the sale of land to 150,000 independent farmers, but Gorbachov merely reasserts his policy of long-term leases for farmers, implementation of which has been blocked by collective farm and state farm managers in many regions.

Prices will be raised gradually, by government decree.

Breakdown and breakup

These measures are for a country where—on top of worse shortages than at any time since the aftermath of World War II, and public health emergencies ranging from diphtheria in Moscow to cholera in the south—there is a profound collapse of infrastructure and power generation, which give an economy the ability to activate its other capacities. As much as one-third of what should have been the harvest of the century went to waste in the fields of Russia and Ukraine this fall, due to shortages of fuel, manpower, and means of storage and transport. One after another heavy industry machine-building plant has been idled for want of rolled metal.

Pravda of Aug. 11 reported on the dire situation in the electric power industry, after numerous nuclear plant shutdowns in the wake of the 1986 explosion at Chernobyl. It cited industrial specialists at the Soviet Academy of Sciences who warned, "Soviet power generation is on the threshold of a very acute crisis, whose equal it has not experienced for many decades. The pace of development of power generation has fallen by at least a factor of three." They forecast that this decline will force a *20% reduction in electricity consumption* by the mid-1990s.

Abel Aganbegyan, the man charged with synthesizing the economic plans, told the Supreme Soviet in September, that the economic situation had become "catastrophic." In 1988, he said, there were severe shortages of consumer goods and a reduction in living standards. In 1989, came a crisis of payments on the foreign debt, which slashed imports. And in 1990, "the direct collapse of economic ties has begun, a sharp decline in the value of money, a shift toward barter, and a spontaneous, uncontrolled fall, at an ever accelerating rate, in public-sector production." He reported that 400 factories had already ground to a halt, with "*several thousand more* on the brink of stopping." Thus, "We are close to the limit beyond which disintegration of our economy, chaos, disorder, and social shocks start."

By the beginning of September, fewer than 10% of 1991 delivery contracts among companies had been concluded, instead of the process being completed by the end of that month, as had been the rule in the past. Unable to wait for agreement on the market transition, Gorbachov on Sept. 4 put Deputy Prime Minister Lev Voronin in charge of "questions to do with completion of the economic year" respecting supply, and assigned State Planning chief Yuri Maslyukov to supervise next year's supply contracts.

On Sept. 24, having packed Aganbegyan off to edit the market drafts, Gorbachov also obtained from the Supreme Soviet the authority to rule national economic policy by presidential decree (*ukaz*) until March 1992. He pressed his case, "We are in a position of extreme danger, and we must act. We are suffering from a crisis of executive power. There is vandalism at work. . . . I ask you for the authority to act, and we will act."

His first *ukaz,* still before the market transition was voted up, was to command republics and local governments, with the threat of heavy fines, to honor 1990 delivery contracts, since "the actions of government bodies and management, leading to the disruption of industrial links among enterprises, is deemed unacceptable." The second decree allowed some wholesale prices to rise. Petrakov told reporters that the next pronouncements from the President will be to create incentives for capital investment from abroad, and to establish a banking system modeled on the U.S. Federal Reserve!

Will the republics now obey Gorbachov? A big selling point of the Shatalin Plan was that it had been accepted by most of them. Aganbegyan commented in September, that the presidential group had "done what was almost impossible—achieved a consensus of the positions of the President of the U.S.S.R. and the leadership of 14 republics." (Estonia withheld endorsement.) Shatalin points out that his original assignment was to find a concept for "transition to a market economy *as the foundation of a Union treaty,*" i.e., a new political foundation for what has been the Soviet Union. The political heart of the Shatalin draft was its allocation to the republics of the authority to carry out privatization, at what-ever rates they pleased. With central authority over taxation and other key areas restored, their support is uncertain.

All summer, the Russian Republic and Union governments sparred over who should control banking and natural resources. The R.S.F.S.R. declared its right to approve or veto deals involving raw materials located on its territory, which would have applied to the recent Soviet diamond marketing deal with DeBeers. Gorbachov issued a decree to override this claim. But in late August, Russia's Foreign Economic Relations Minister Viktor Yaroshchenko was making noises about observer status and then membership in OPEC for the Russian Republic, which produces 80% of Soviet oil.

On Sept. 21, when Gorbachov sent the Shatalin Plan back for further hybridization with the government's proposals, Filshin declared that the Russian Republic would begin to implement the 500 Days agenda on Nov. 1, with or without support from the U.S.S.R. central government, and the R.S.F.S.R. Supreme Soviet passed a resolution to that effect. Later, Yeltsin tempered the threat with hints about waiting six months until the new central efforts failed.

An official like A.I. Volsky, president of the Scientific Industrial Union of the U.S.S.R., could see the handwriting on the wall, as he pleaded for private property and ruble convertibility, only in the setting of an all-Union market. "There is a universal trend now toward separatism and disintegration," Volsky told a government meeting in August. "We cannot fail to see this. The republics are beginning to adopt decisions that are totally humiliating for the Union, for the ministries and industries. For example, the Ukrainian Gosplan [state planning agency] has apparently issued instructions prohibiting Union enterprises from signing contracts with other republics."

In the Baltic states, as well as Ukraine, there is talk about setting up separate currencies.

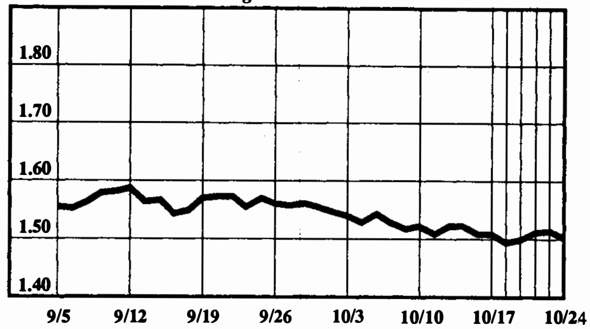
Further complicating matters is the outbreak of demands for economic sovereignty, from dozens of Autonomous Soviet Socialist Republics that are juridically within the R.S.F.S.R. Several would bolt from the R.S.F.S.R. if the government went through with price hikes, *Izvestia*'s Mikhail Berger predicted in August, adding that "the actions of the central authorities are intensifying the already powerful centrifugal tendencies." Soon, he said, people would be worrying about non-aggression treaties, not economic treaties, among the republics and autonomous republics.

When the Supreme Soviet convened, *Izvestia* reported Sept. 16 that "first place in terms of the number and persistence of the questioners there came, utterly unexpectedly for us and, it seems, to the authors of the programs, the problem of the participation of autonomous republics and oblasts in the process of transition to the market. . . . To what does this attest? To the growth of national self-consciousness? Probably. But even more probably, to how badly we are all living, if we are prepared to rush in all directions."

Currency Rates

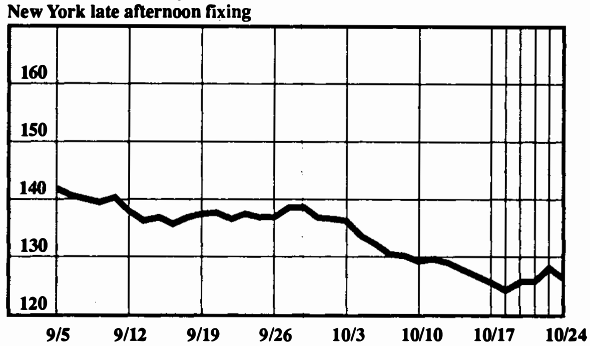
The dollar in deutschemarks

New York late afternoon fixing



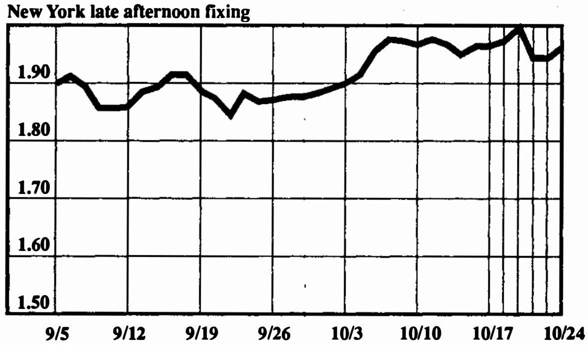
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing