Sachs is on the ropes for 'shock' policies

by Our Special Correspondent in Davos

The man who drafted the controversial monetary "shock therapy" policies for the government of Poland, and most recently for Russia, 36-year-old Harvard economist Jeffrey Sachs, is becoming extremely defensive about the obvious failure of his program. During a Jan. 30-31 seminar to a group of international business and political leaders in Davos, Switzerland, Sachs feebly struggled to defend his "success" in Poland and in Bolivia, the country where his entire reputation has been based, amid growing charges that his policies have brought nothing but chaos to the countries of eastern Europe.

By far the most controversial issue in the Davos discussions was the Jan. 2 adoption by Russian Economics Minister Yegor Gaidar of Sachs's now standard recipe for "shock therapy": a "free float" in prices of essential foodstuffs and many other commodities. This was alleged to be the way to bring under control Russia's runaway inflation, today conservatively estimated at far in excess of 200% per annum, by soaking up the rubles printed by past governments in an effort to pacify the population and to paper over huge state budget deficits. The Sachs plan also calls for drastic cuts in the state budget deficit and imposes a draconian value added tax on sales of many goods.

Nikolai Shmelyov, a professor of economics from Moscow, and a member of Russian President Boris Yeltsin's Advisory Council, was scarcely enthusiastic about the Sachs-Gaidar policy. He told the Davos audience: "What is going on in Russia since Jan. 2 is comparable to cutting the leg of a patient without using anesthesia. In 1947 Stalin liquidated the debt of the state simply by robbing the people of their savings, when 90% of private savings were confiscated. Yeltsin politically can't get away with the same methods now, so he makes the same policy in disguised form. In one to two months more, all private savings will have been confiscated from the population."

The Moscow economist added: "If the government now, in addition, decides to move to ruble convertibility, on top of the price float, it will be the equivalent of playing Russian roulette with the national economy. The government must do something to calm the population."

An associate of Sachs, Marshall Goldman of Harvard's Russian Research Center, also took sharp issue with the "shock therapy" model. "I have to differ with my friend Jeffrey Sachs. He insists to me that the shock program in Poland is beginning now to produce results, but even if we accept that it is, Russia is different from Poland. In Russia, the country is imposing monetary shock while at the same time the country is in the process of breakup. It is creating a 'supply-side depression,' with inflation, ethnic tensions, and the state still holds the monopoly on production." Goldman disputed the Yeltsin government's official claim of "only" 300-400% price increases in basic goods since January. "Prices in reality have risen by tenfold or more," he said. "This has caused a huge drop in demand, so naturally goods reappear in the shops."

The Polish model is a failure

Sachs himself was unable to give any but the most clumsy effort to justify his controversial monetary policies. A journalist asked him point-blank, "Tell me, Mr. Sachs, I have not been able to find one single country where 'shock therapy' has succeeded in raising the overall standard of living of the population—not in Poland, and certainly not in Bolivia." A clearly agitated Sachs snapped back, "What do you mean? Poland has doubled its exports and doubled its imports, in dollar terms, since 1988."

Sachs's selection of the time frame is bizarre, especially since former Polish finance minister Leszek Balcerowicz did not implement Sachs's shock medicine until two years later, in early 1990. The condition of Poland's population in that time has deteriorated horrendously by all accounts. During the first year of Poland's adherence to Sachs's rigid recipe, total industrial production in 1990 plunged 23%, and another 15% for 1991, bringing present production levels, according to estimates of the Economic Commission for Europe, down more than one-third since the onset of "shock therapy." State-owned companies have been forced into bankruptcy amid soaring interest rates, and a wage austerity policy imposed by Sachs and the International Monetary Fund (IMF). Sachs did not care to admit the reality that Polish household incomes, measured not in dollars but in zlotys, had fallen by fully 20% in the nine-month period to August 1991.

Moreover, a just-released Polish government statistical survey for 1991 admits that Poland's unemployment, almost non-existent in 1988, doubled in 1991 from the previous year to more than 2 million, some 11.4% of the labor force, with expectations of an unprecedented 3 million jobless by the end of this year. The survey also shows an annual inflation of 60%, despite two full years of Sachs's anti-inflation policy. Further, imports in 1991 did officially grow, but this was largely because Soviet oil import costs rose by 72%, hardly a sign of economic success as Sachs's comment suggested. And the volume of merchandise exports for 1991 ground to a virtual halt. Little wonder that in a Feb. 5 communiqué, the new government of Prime Minister Jan Olszewski announced plans to move away from the "shock therapy" policies.

Polish President Lech Walesa charged bitterly, in a speech before the European Council in Strasbourg, France, on Feb. 3, that Poland has been betrayed by the West. Poles feel that they had support only as long as they were needed for detonating the "old order" in Europe, he said. Now that job is done, and the West is closing its borders to Polish export goods, is not investing in the Polish economy, and is only interested in extracting money from Polish consumers. "You have made a profit from the Polish revolution," said Walesa.

The Bolivian 'success story': cocaine

Sachs was challenged at the Davos gathering on his so-called success in Bolivia, where the young Harvard professor first claimed that he had accomplished the "miracle" of curing hyperinflation. Sachs told his challenger at Davos, "I have a friend who is just back from Bolivia and he tells me that in the countryside, the economy is booming!" His critic replied, "Yes, but that's because those are the very areas where the 'booming' coca cultivation for the world cocaine market is grown! But what have your policies done for Bolivia's tin mining industry for example?"

At that point, an obviously flustered Sachs blurted out, "Jesus! That's what my whole policy is all about—to get rid of the tin industry!" He then ran hastily from the room, leaving unanswered the charges of fostering the coca economy through his monetary measures.

Is Russia in a bottomless collapse?

In other discussions at Davos, radical monetarist Anders Aslund, of the Stockholm Business School, tried to defend Sachs and the "Thatcherist" anti-state economic policy, only to be confronted with the comments of former Gorbachov economic adviser Abel Aganbegyan, who reported: "In Russia we have had almost a 30% collapse in GNP since 1989, with no end in sight. The standard of living is collapsing. We have no stable banking system, no real agreement among the new states of the Community of Independent States. Price liberalization is very dangerous, and is creating hyperinflation and hyper-unemployment." He added that there exist at present no effective state structures for organizing oil production or transport, and accused the Yeltsin government of lacking any overview of the explosive social situation. "The price reform itself has even been badly organized," he said. "Some in Moscow say we must do all this in order that we would in April or so get some $5-6 billion ruble stabilization fund from the IMF. But $5 billion or even $10 billion for a country of 300 million is nothing. All export earnings now are going to service foreign debt, and half of that is short-term."

Underlining the acuteness of the situation, the Russian State Statistics Committee, Goskomstat, reported on Feb. 4 that Russia is going to start running out of supplies of beef and poultry in 19 days, vegetable oil in 20 days, butter in 30 days, and sugar in 41 days.

The Moscow newspaper *Sovetskaya Rossiya* early in February accused the Kremlin leaders of "committing planned genocide" with the Jan. 2 adoption of Sachs's recommendation for a food price hike, while keeping salaries, pensions, and student grants much lower. "Market prices are absolutely out of reach for 85% of the population," the paper charged. "Thus, the transition . . . to a 'market-led' economy has resulted in a shortage of protein in people's daily diets, which will soon lead to health disorders." As a result, the paper predicted that the Russian population will *drop* by 10 million within 10 years.

At the Davos forum, a number of other prominent Russian reform leaders underlined the disastrous results of the Sachs policies, including Gavriil Popov, the mayor of Moscow, and Anatoly Sobchak, the mayor of St. Petersburg. Sobchak told the seminar, "If it had not been for the emergency European Community food aid, we would have been on the verge of a social explosion; as it is, we are still near the brink." "Moscow," Sobchak charged, is "not keeping close tabs on the results of their reform. Gaidar is far too optimistic. He says prices have risen only 3-4% since his program. In reality I can tell you they have risen 12 times or more, with most food items higher by 10 to 15 times! This is very dangerous."

Sachs attempted a feeble joke by asking the audience if anyone had any "good news" about Russia, and quickly brought the seminar to a close when no one did, claiming there was "no more time" for questions.