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THE COUP'S CONSEQUENCES FOR ECONOMIC REFORM

Leonid Grigoriev
E.L. Wiegand Fellow

INTRODUCTION

The failure of the August 19 hard-line coup in the Soviet Union has transformed the political situation in that country, sweeping the Communist Party from power and clearing the path for a rapid transition to a market economy and democracy. The coup attempt demonstrated the vulnerability of democracy unsupported by a free market economy.

Prior to the coup, a terrible economic situation was exacerbated by political uncertainty, increasing internal strife between the republics and nationalities, economic and political strikes, and repeated postponement of genuine economic reform. To these factors were added general disorder, a structural crisis, economic recession, and inflation.

The eight plotters of the coup proposed saving the country by turning the clock back and undoing many of the reforms of the past several years. In an irony of history, Soviet President Mikhail Gorbachev had retreated from previous promises of quick reform. His goal was to preserve social stability through a slow, piecemeal approach to evolutionary change. It did not work.

Good News and Bad News. The failure of the coup has brought both good and bad news for Soviet economic reformers. The good news is that the coup has undermined the power of those most stridently opposed to free market reforms: the top bureaucracy of the Communist Party, the KGB, the military, and the enor-

Heritage Foundation E.L. Wiegand Fellow Leonid Grigoriev is one of the architects of the 500-Day Plan for radical economic reform discussed in this study. In Moscow, he is a Department Chief at the Institute of World Economy and International Relations, Profsoyuznaya str., 23, Moscow, 117418, U.S.S.R., FAX 3107027.

mous Soviet military-industrial complex. In addition, Gorbachev's timid and halting approach to economic reform has been discredited in favor of much bolder measures.

The bad news is that the long-term problem of reforming a rapidly disintegrating and backward economy remains. With their political victory, Russian President Boris Yeltsin and his colleagues in the other republics inherit an economic mess. To make matters worse, the crippled Soviet economy likely will be wounded further by the current political upheaval. Even as they embark upon free market reforms, the new authorities throughout the country must keep the present economy working or face the prospect of dangerous social and political instability.

For this reason, it is critical that the republics reach agreement on free trade, currency and banking reforms, price liberalization, and the development of a compatible legal system in which a modern free market economy can flourish. Economic reforms in the republics should be designed to be as similar and thus as compatible as possible to enhance the prospects of overall success.

THE CHALLENGE TO SOVIET REFORMERS

Soviet leaders face a daunting task. Prior to the coup, the leaders in the republics had been too preoccupied with the political struggle to devote sufficient attention to long-term economic reforms. The republics' economic reform record was sparse partly because the Soviet government tied the hands of the republics and frustrated their efforts toward reform. But it is also true that the republics themselves frequently were not free market reform-minded. Short-term political goals and the necessity of securing public support against the central government led republican leaders to back populist measures harmful to economic reform. Such measures included enormous wage increases unsupported by corresponding increases in productivity. The overall budget deficit and excess money supply, meanwhile, contributed to unbalance the consumer market. These led to the expectations of shortages and, predictably, to hoarding.

Before the coup, all economic ills could be blamed on the central Soviet government. Now, however, the blame will shift to the republics as their leaders wrest vast powers for themselves from the central government. No longer can the republics' leaders avoid responsibility for the state of the economy. Almost certainly, their honeymoon with an increasingly impoverished and impatient society will be short.

Unlike Gorbachev, they will not have a half-dozen years to play with economic experiments. Four years of increasingly inept programs were required before Gorbachev and other Soviet leaders could bring themselves to acknowledge in 1989 the reality that true *perestroika* requires radical free market reforms. Even then, they continued to delay their implementation. Gorbachev's refusal in September 1990 to adopt the so-called "500 Days Plan" of radical economic reform wasted an entire year. Now, however, the coordinated approach to economic reform that the 500 Days Plan could have provided almost certainly will be precluded by the republics following different paths.

Economic Tower of Babel. Since the economic reforms of countries such as Hungary and Poland are more advanced and better known than those in the Soviet Union, it is instructive to compare some of the principal differences between these countries. Unlike Hungary and Poland, economic reform in the Soviet Union has not been introduced by professional economists. The suddenness with which the communist system in the Soviet Union collapsed has allowed the democratic forces little time to discuss and debate the merits of different approaches to economic reform and develop technical expertise. Consequently, every politician has his own vision of the economic system to be constructed, a virtual Tower of Babel of economic reform.

Most important, the necessary tightening of the current inflationary monetary policy has been made much more difficult by the dismantling of central authority. From the standpoint of monetary reform, it would have been much better if the disintegration of the Soviet Union had followed, rather than preceded free market reforms.

Today three competing economic reform programs are being discussed in Moscow. The program advocated by Grigory Yavlinsky, one of four members of the Committee for the Management of the National Economy, recommends the preservation of a strong and coherent economic union including an integrated banking system, a single currency at least for one to two years, and a common international economic policy. Other programs would leave economic reforms in the hands of the republics, thereby slowing the pace of reform.

IMPLICATIONS OF THE COUP

The effects of the August 19 coup on economic reform are mixed. The first effect is psychological relief. Since the December 1990 resignation of Foreign Minister Eduard Shevardnadze and the replacement that month of Vadim Bakatin as Minister of the Interior by the reactionary Boris Pugo, the population has been waiting for a showdown between hard-liners appointed by Gorbachev and democratic reformers. During this time, the economy steadily deteriorated, making life for the ordinary citizen even more difficult. This atmosphere of political and economic insecurity impeded economic reform. For example, the growth of the private sector, especially the establishment of new businesses, was hampered severely by a fear of reprisals against entrepreneurs if the communist hard-liners took over power. Now the shoe has dropped. The hardliners have made their anticipated move and have failed.

A second benefit of the coup is that the reactionary communist forces have been clearly identified. Until August 19, most of the political leaders of the Soviet Union glibly invoked the rhetoric of free market reform, while in fact advocating profoundly different approaches. Western observers, in particular, often were mystified why this apparent consensus on economic reform produced so little in the way of genuine market reform. Now, however, the anti-reformist forces behind the coup have surfaced and been capsized by a wave of popular opposition.

West Misled. Over the past year, the true reformers in the Soviet Union warned their Western friends and colleagues to listen with reservations to the Soviet establishment regarding the course of events. But many in the West, especially those in government, were too easily misled by a willingness to believe their Soviet counterparts. Many Western journalists too, curiously, were misled easily. Consequently, these Western governments treated Soviet Prime Minister Valentin Pavlov's government as their preferred partner. Only the coup made this approach politically untenable. Now all of Gorbachev's former cabinet has been dismissed, including all those upon whom Western governments were relying to promote economic reform.

In contrast, the true reformers steadfastly have distanced themselves from the central government since that government rejected the 500 Days Plan in September 1990. These reformers are now free, politically and intellectually, to help in economic reform. The coming to power of leaders such as Russia's Yeltsin creates very promising political conditions for radical market reform, but its successful implementation will require the fullest cooperation between economists and political leaders.

The failure of the coup has created an excellent opportunity to destroy the power of the *nomenklatura*, the Communist Party bureaucracy which controlled the economy and was capable of frustrating all reforms in recent years. By refusing to share power with the emerging democratic forces throughout the Soviet Union and by clamping down on private economic activity, the *nomenklatura* in the central government was able to force Gorbachev to slow his reforms.

The local *nomenklatura*'s resistance to reform arose from a desire to protect its members' rank and social standing (including privileges) in society. Its special place in the system was derived from its control over the local economy. Now, if the *nomenklatura*'s power is broken as a result of the coup, businessmen and entrepreneurs will have considerably more opportunity to operate. Nevertheless, there remains the danger that the population may come to regard the entrepreneurs in the same negative light as they now do the *nomenklatura.*

Risk Reduced. A third benefit of the failure of the coup is the long-term effect on the economy and on economic reform. To begin with, the social and political risk of entrepreneurial activity has been reduced substantially. The same is true for foreign investments. No longer is there the threat that property and capital will be seized upon the whim of a bureaucrat nor the danger of criminal prosecution for engaging in private economic activity. In addition, foreign assistance now is much more likely. But at the same time, the erosion of the central government's authority has diminished its ability to implement a comprehensive reform for the entire country from the top—in the East European style.

One very big question is how the public will react to radical reforms, especially during the transition period. After six years of false promises and increasing economic misery, it is by no means certain that the population can be persuaded to work harder. Public trust in any kind of government reform program clearly is very low.

Difficult Message. Although the failure of the coup gives new hope to many people, much of the population remains passive and large segments fear losing even their present standard of living. No political leader has yet had the courage to tell the people that the transition to a market economy will entail hard work and that only a tiny minority will become rich soon.

This news may not be welcomed by the large majority of poor people in the Soviet Union. Much of the population dreams of a quick transition to Western living standards. Soviet publications have contributed to this illusion by their emphasis on the rosier aspects of market economies, such as high technology, much as they formerly created a negative image through stories of Western unemployment and inequality of income.

The main goals of the transition—creating an efficient market economy and the foundation for a stable democracy—will inevitably lead to some inequality. It will take some time before an emerging middle class will be able to stabilize social and political life. Therefore, it is necessary to explain to the population why inequality is unavoidable, and for what purpose they now must work and sacrifice. It is especially important — but difficult — to convince them of the need to be patient once again.

THE GOALS OF ECONOMIC REFORM

Given that the country does not have a stable government, that it faces the actual political secession of several republics, and that the republics may each choose a different road to market reform, what should be the goals of the transition? The economic and social costs of the transition to a market economy should be minimized. This is essential not only for humanitarian reasons, but to avoid a popular backlash that could derail the entire reform process.

Some important areas of reform are:

♦ ♦ **Legal System.**

The legal system for a market economy does not now exist, and its development will take time, especially in the current unsettled political climate. The disintegration of existing government structures is creating considerable legal uncertainty. So, too, is the rapid change of existing laws and regulations. It is necessary to decide first of all which law is valid: union or republican. And property rights are still not defined, especially concerning land and real estate. Such laws as bankruptcy codes, contract regulations, and privatization law should be reassessed and quickly approved.

♦♦ Internal Trade.

Trade within the Soviet Union overnight has become in effect foreign trade between republics. This trade can be damaged by the republics and regional authorities adopting protectionist measures, such as regulations restricting the export of consumer goods to other regions. Some authorities also have extended these restrictions to construction materials and other goods.

The old system of internal trade by governmental command has steadily been replaced by barter. The Soviet government viewed trade by bartering as illegal and inimical to the Soviet economy, but was unable to prevent it. Attempts by the central government to stop barter trading created obstacles to the flow of goods, services, and money. And this slowed even more an already poorly functioning economy.

This attempt to hinder barter trade is certain to continue, particularly as part of a misguided effort by the republics and regional authorities to protect local living standards. The central government has lost any ability to prevent it. If the republican governments persist in trying to stop it, the result is certain to be a no-win situation in which industrial production and living standards continue to fall.

An additional contribution to this growing disorder is the widespread breaking of contracts. At present, there is no legal recourse if a contract is broken. Nor is there discipline imposed by the market in the form of bankruptcy costs and courts.

♦♦ Prices.

The loss of central control over economic enterprises means that price liberalization is inevitable. Much of the Soviet economy is riddled with monopolies, especially in technology. More than half of them involve machinery: a single enterprise may produce 60 percent to 100 percent of the Soviet Union's output of certain categories of machinery. The republics in which such enterprises are located may reduce production of machinery components needed elsewhere in the Soviet Union. Meanwhile, a monopoly could raise the prices of these products for export to other regions and thus cause hyperinflation and price wars. There could well be a "price shock" as Soviet internal prices rapidly increase to world market levels, especially in energy and raw materials.

Such an adjustment is inevitable in the long run, but the present situation will accelerate it. Several products quickly will become sources of trouble, especially oil, cotton, sugar, grain, and other specialized agricultural goods. Their production and distribution is largely controlled by the republics. In these conditions, it will be very difficult to monitor consumer prices and to establish a "safety net" for the poorest segment of the population.

♦♦ Currency and Banking.

Both the theory and practice of market reform demonstrate that a relatively strong, stable currency is a prerequisite for market signals to operate. Without these, a true market cannot emerge to replace the quickly vanishing command sys-