

and dynamic totalitarian model is the only one that is appropriate. With this perspective as a base and a background, our social science techniques, whether in economics, political science, sociology, or history, can at last bear fruit in a manner proportionate to the effort invested in developing them. They can no doubt also aid our Eastern colleagues in effecting the "return to Europe" to which they have aspired since the onset of *perestroika*.

Sovietology and communist studies need not go the

way of the Soviet Union and communism into oblivion. For some decades to come, there will be a vast and valid field of post-Soviet, postcommunist studies, applicable from the Caribbean to the China seas, in lands where a third of the human species has for various periods in time been subjected to the Marxist-Leninist fantasy. And this shared calamitous experience will continue to mold their relations with the rest of the world for as long as it will take them to become integrated, at last, into a genuine modernity.

## Commentary

# Toward a Postcommunist Economy

**Yuri Maltsev**

THE presentation by Martin Malia demonstrates that he is one of the few members of the Sovietological profession who realizes the true significance of the August Revolution of 1991 in Moscow. That revolution marked the final stage of the century's most dramatic event—the rise and fall of socialism. The failure of the desperate and incompetent Kremlin bureaucrats to revive the ancien régime represents the complete collapse of Marxist-Leninist ideology and all its philosophical underpinnings.

Malia's paper is the cruiser "Aurora's" shot of today's revolution at the *nomenklatura* of Western Sovietology. Sovietology discredited itself through its politicization and normative approach. However, the "real life" behavior of the subjects of Sovietology proved it to be ab-

solutely out of touch with reality. Even today, some of our colleagues are still trying to convince us that the problem is not with their understanding of the events but with the events themselves. To follow their logic, the peoples of the postcommunist countries did not follow our enlightened advice and behaved differently from what Sovietology predicted.

Arrogance, illiterate imperialism, the intention to impose the policies that were rejected by an absolute majority of people in the former Soviet Union and Eastern Europe are characteristics of those Sovietologists who call themselves "pragmatists." They are visible and vocal. They created "Gorbachev's personality cult" in the United States, and they are very close to the political process irrespective of who is in the White House. The pragmatists labeled everyone who disagreed with the arguments of "reformed communists" from Nikolay Bukharin to Mikhail Gorbachev as "conservatives," "reactionaries," or "blind in their anti-communism."<sup>1</sup> The "pragmatists" were actively trying to save the Soviet

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<sup>1</sup>One probably does not have to be a great economist or statistician to understand that the Soviet economy was going to hell in a hand basket, but I know of no single piece of mainstream Sovietological research except Marshal L. Goldman's *USSR in Crisis. The Failure of an Economic System* (New York, Norton, 1983) that in the early 1980's or before had predicted the present Soviet economic crisis. All of the epithets mentioned above were immediately applied to him.

empire in an attempt to prolong the life of structures that were voted out by 86–97 percent of the populations in question. As Padma Desai, for one, puts it:

*The Bush Administration, caught between pragmatists inside and outside the White House who favor a closer Soviet union with some central control, and conservatives, who believe the republics should be allowed to go altogether their own way, is sitting on the fence. But it needs to be more active, using aid to pressure republics to take the pragmatic route.<sup>2</sup>*

Following this strange logic, we can assume that the "conservatives" took over the White House during the Truman, Eisenhower, and Kennedy administrations and "allowed" the peoples of the British, French, and Portuguese empires "to go altogether their own way." These evil people then infiltrated the United Nations, which in 1960 adopted the Declaration of Independence of Colonial Nations, while the "pragmatists" later attempted to stop these disastrous developments in Southeast Asia.

### The Miscalculation of Sovietologists

Malia, unlike most Sovietologists, seriously deals with the problem of economic calculation under socialism, which is the most important clue for understanding the collapse of the socialist system. Failure to understand the importance of this problem was precisely the reason for the failure of Western Sovietology to realistically assess the nature and viability of command economies.

Even though some Western academics believe that the USSR "has an advanced system of collecting and evaluating economic statistics,"<sup>3</sup> Soviet economic data were probably the least reliable in the world. These statistics gauged the performance of a non-economic system and, correspondingly, were based on a non-economic methodology. Moreover, until recently, statistics were also treated as a form of economic propaganda and widely used as an illustration of the "success" of the regime's economic and social policies. Propaganda, however, played a much less significant role than flawed methodology.

One of the main shortcomings of mainstream quanti-

tative estimates of Soviet economic performance, as Malia points out, is a methodological one. A good example is the uncritical application of neoclassical theory to the Soviet economy, as in the case of the concept of producer-cost minimization used by the pioneer of Soviet economic analysis, Abram Bergson. The principle states that a producer always strives to minimize costs and, consequently, any cost increase (other things being equal) is associated with a rise in quality. In the Soviet Union, however, the situation was exactly the opposite—producers want to maximize costs (inputs) and minimize outputs. The reason is well known. Soviet planning was based on the so-called "ratchet principle," according to which an enterprise's plan for one year is determined by its success in fulfilling the plan for the previous year. For example, if the enterprise exceeds its planned output by 20 percent, the next year's plan will include the attained level of output as a new base. Under these circumstances, Soviet data on housing construction, or any other capital investment, are quite misleading because enterprise managers inflate the number of inputs necessary to make a given product in order to ensure that they have sufficient resources to meet their plan targets. But this means that the costs of inputs do not reflect the quality of the product.

Without a market mechanism, there really is no way to determine when and how cost increases relate to improvements in quality. Thus, one is strongly tempted to agree with Malia's conclusion that the only valid theoretical evaluation of the socialist model was that of the Austrian school of economics, which concluded that it is impossible to measure what is going on in the Soviet economy.

The Marxist labor theory was also a major source of methodological distortions of Soviet statistics—land and other natural resources (water, timber, air, etc.) were not regarded as having value because no labor was expended on their production. A related Marxist dogma applied to statistical methodology was the concept of "productive" and "nonproductive" labor. Production, according to this view, is the result of social labor in material form. The "social" character of labor is manifested in the cooperation of labor in society, and in the unity of production, distribution, and consumption. The product is "material" if it satisfies "material" needs. However, in reality, this term also embraces energy, communications, transportation, and other activities that increase the costs of material goods created elsewhere. In the Soviet Union, services and other "non-material" costs were not included in determining value. Moreover, national accounts in the USSR were calculated by simply adding up the value of all material in-

<sup>2</sup>Padma Desai, "Keeping the Soviet Economy Under Control," *The New York Times*, Oct. 5, 1991.

<sup>3</sup>D. Steinberg, "The Real Size and Structure of the Soviet Economy: Alternative Estimates of Soviet GNP and Military Expenditures for 1987," prepared for the American Enterprise Institute conference Comparing the Soviet and American Economies: Overall Output, Levels of Consumption, Military Expenditures, Warrenton, VA, Apr. 19–22, 1990, p. 3.

puts and labor at their state prices. The artificial exclusion of services is by far the most drastic difference between the national accounting system of the USSR and that of the West. Indeed, it leads to some real paradoxes. A dentist, for example, is a "nonproductive" individual while a dental technician is a "productive" one.

There were still other problems with Soviet statistics. Labeling the concept of interest as "bourgeois" resulted in skewed estimates of investment costs. Thus, in choosing between two industrial projects in which to invest, only their current costs were taken into account and not alternative uses for investment funds, where the rate of return would have been calculated on the basis of the rate of interest. The labor theory of value distorts economic statistics because it neglects the independent variable of the time factor in economics. Nor were outputs of some industries that became inputs for other industries eliminated to avoid double counting of value added. The value of inventories in all industries concerned was fixed arbitrarily by government bureaucrats without any regard for an accurate assessment of sales, profits, or production performance.

The bias in favor of hard numbers inevitably led Sovietologists to swallow Soviet lies irrespective of whether they were "pragmatists" or "conservatives." Contemporary mainstream Sovietology is based on the principles of positivism—a scholar dealing with quantitative data is expected to produce hard and exact numbers (and to be precise in his calculations). But the use of positivistic approaches may lead to an illusion of precision among economic researchers. In fact, Western Sovietologists were aware of the danger, but, at the same time, they maintained that it was better to "be exactly wrong than approximately right." Unfortunately, they could not attain even that standard, because there were different degrees of being wrong.

Another common flaw in Sovietology was its neglect of consumption. In treating the socialist economy as a real economic system, Sovietologists were trapped by official Soviet statistics on consumption, which, by definition, are supposed to be more or less in equilibrium with production. Kenneth Boulding's well-known Bath-tub Theorem,<sup>4</sup> which holds that over the years the average rate of production and the average rate of consumption must be equal, cannot be applied to a society that lacks a market. At the beginning of the 1990's, personal consumption in the Soviet Union ranked 77th in the world, and its people were the poorest in the developed world.<sup>5</sup> Compared to the average American, for example, the Soviet citizen even before the January 1992 price hikes had to work 12–15 times longer for butter, 15–20 times longer for eggs, and 10 times longer for bread. Production was greater than consumption

for 69 out of the 74 years the Soviet economy was in existence. This is an absurdity from the point of view of serious economics. Simply put, hundreds of thousands of factories did not produce goods ready for use; in the majority of cases, unfinished goods and producer goods were manufactured. Every good had to proceed through a whole series of stages before it was ready for use; yet, in each stage, there were no market signals to help managers design a method of production that would result in a product that was both profitable and fulfilled real consumer needs.

This is no small matter of concern. On an economic level, we have a prediction made in 1920 by Ludwig von Mises, who said that cost calculations under socialism are impossible owing to the absence of a rational accounting system:

*One may anticipate the nature of the future socialist society. There will be hundreds and thousands of factories in operation. Very few of these will be producing wares ready for use; in the majority of cases what will be manufactured will be unfinished goods and production goods. . . . Every good will go through a whole series of stages before it is ready for use. In the ceaseless toil and moil of this process, however, the administration will be without any means of testing their bearings. It will never be able to determine whether a given good has not been kept for a superfluous length of time in the necessary processes of production, or whether work and material have not been wasted in its completion. How will it be able to decide whether this or that method of production is the more profitable? At best it will only be able to compare the quality and quantity of the consumable end-product produced, but will in the rarest cases be in a position to compare the expenses entailed in production.<sup>6</sup>*

## The Analysis of Soviet Military Potential

Another serious error in studies of the Soviet economy had to do with the defense budget. Before May 1989, the annual figures for defense expenditures published by the Soviet government were obviously too small to encompass the scope of the Soviet military buildup. The US and other Western governments thus

<sup>4</sup>Kenneth E. Boulding, *Economic Analysis*, New York, Harper & Row, 1966, Vol. 1, p. 170.

<sup>5</sup>V. Radayev and O. Shkaratan, "Return to Essentials," *Izvestiya* (Moscow), Feb. 16, 1990.

<sup>6</sup>Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth*, Auburn, AL, The Ludwig von Mises Institute, Auburn University, 1990, p. 9.



allocated substantial resources to make estimates of their own. Alongside the intelligence community, substantial efforts to establish the real size of the Soviet military economy and military expenditures were also made by numerous academics both in the West and in the Soviet Union itself. Most of these studies sought to find some magic formula that, using official Soviet figures, would provide the "real" numbers. This approach is obviously absurd—if one multiplies nonsense by any figure, the result is nonsense.

The main problem here is the unresolvable one of comparisons between a market and nonmarket economy. Thus, the numerous estimates of the share of the Soviet GNP going to the military, which ranged from the low official Soviet figure of 9 percent, to the US Central Intelligence Agency's 17 percent, to the RAND Corporation's 21 percent, are all equally invalid. Moreover, there is absolutely no assurance that the truth lies somewhere in between these figures. The CIA did not deflate Soviet physical data and did not acknowledge the inferior quality of Soviet production. Its statistics are probably comparable only to those of Goskomstat in their irrelevance. The real figure probably is much higher than the most generous estimate cited above. Aron Katsenelinboigen wrote that "if we look structurally at Soviet military expenditures, they turn out to be all the country's expenditures minus the production costs of consumer goods and services, which would be cut back in the event of a war."<sup>7</sup>

### The Roots of the Crisis

For many decades, economic activity in the Soviet Union was used for the fulfillment of communist political ideals "at any price." The peculiarities of the economic and political structure of the USSR, combined with its low level of economic development and social organization, made it a unique phenomenon in the world economy. The decades-long effort to eliminate free markets resulted in the almost total monopolization of the economy, the destruction of the work ethic, and the absence of incentives for capital accumulation. The suppression of individual initiative has led to widespread apathy and the inability of the public to make independent decisions, as well as to a complete lack of individual responsibility on behalf of all types of managers. The result—Chernobyl, catastrophes at nuclear power stations near Chelyabinsk, and numerous other man-made disasters, such as the drying up of the Aral

Sea. The command economy distorted the means of economic calculation, and technology is now so obsolete that the capital stock of many industrial enterprises possesses zero or even negative value. Most Soviet heavy industries were built during Stalin's industrialization campaign in the 1930's and have not been seriously remodeled since. Moreover, the system of central planning would not permit the closing down of any enterprise built since 1917, irrespective of the enterprise's efficiency. It is clear that decisions concerning the economy were made on the basis of politics. The system discouraged risk-taking, punished efficiency, and led to unprecedented waste of resources, slowdown of technological progress, and chronic shortages of goods and services. The collapse of the Soviet Union is not the result of a military defeat but of the policies of the Soviet government.

The first sign of the coming Soviet economic collapse, which went unnoticed in the West, was the increase in state subsidies to unprofitable enterprises at the end of the 1970's and the beginning of 1980's. During this period, more than 30 billion rubles of the state budget were allocated annually to support unprofitable industrial enterprises. Huge losses were covered by currency obtained from overseas sales of oil, gas, and other natural resources. These hard-currency reserves were used by Kremlin bureaucrats to purchase goods on the world market in order to make up for domestic production failures.

By the mid-1980's, the deterioration of the Soviet economy reached a critical point. More than 50 percent of state business enterprises were permanently unprofitable but survived due to the provision of huge subsidies,<sup>8</sup> while the agricultural sector required an infusion of more than 100 billion rubles a year to support the feudal collective-farm system.<sup>9</sup>

The August Revolution seriously undermined the position of the forces opposed to radical economic reform. Nevertheless, the danger of the possible new attempts to re-install socialism is still there; the deeply entrenched positions of bureaucracy and military are based on the system of economic statism that is nothing else but the socialist economic system without communist ideology.

Today it is obvious that there will be no changes for the better without the radical overhauling of the obsolete economic system. The share of state property in Russia is the highest in the world (95.4 percent), while

<sup>7</sup>Aron J. Katsenelinboigen, *The Soviet Union: Empire, Nation, and System*, New Brunswick, NJ, Transaction Publishers, 1990, pp. 121–22.

<sup>8</sup>*Ekonomicheskaya Gazeta* (Moscow), No. 11, 1988; *Narodnoye khozyaystvo SSSR v 1988 godu* (The National Economy of the USSR in 1988), Moscow, Statistika, 1989, pp. 620, 621.

<sup>9</sup>*Narodnoye khozyaystvo SSSR v 1988 godu*, op. cit., p. 435.

the private (personal) property of the people amounts to 2.8 percent and that of cooperatives, 1.8 percent.<sup>10</sup> Moreover, irrespective of the recent so-called "market reforms," the share of state property has increased 7 percent since 1980 (the absolute rate of increase of the value of state property was 165 percent; cooperatives, 19 percent; and private property, only 11 percent).<sup>11</sup>

Government and party functionaries have come to believe that state property belongs to them. Given that such people "plan" and manage state property and economic life in general in their own interest, it is not surprising that bureaucrats became the economic elite so thoroughly described by Milovan Djilas in his classic *The New Class: An Analysis of the Communist System*. According to my estimate, the number of these bureaucrats in Russia alone in early 1992 was around 13 million. These elites wish to maintain their economic and political power. Nobel laureate James Buchanan has observed that "rent seeking"—competition for government largesse and protected profits—emerges as a significant social phenomenon as institutions move away from ordered markets toward the near chaos of direct political allocation.<sup>12</sup>

The resistance generated by bureaucrats who have been responsible for directing the enterprises is one of the leading causes of the failure of privatization programs. Reluctant to relinquish their power and privileges, government and industrial officials have many opportunities to delay and obstruct any real privatization. They support only those programs that employ "expropriatory methods" in combination with price increases and the printing of additional billions of rubles. The January 2, 1992, "price reform" of Boris Yel'tsin's government in Russia is the best illustration of this. There was no "free market reform" in this economically absurd measure.<sup>13</sup> The essence of socialism is public ownership; fixed prices are only a consequence of public ownership. Even the well-intentioned manager has no guide to tell him what to charge for goods and services. As long as government monopolizes the processes of production and distribution, the laws of supply and demand cannot work.

Unfortunately, Yel'tsin's government has no coherent plan for structural reform. The Russian parliament

adopted a law calling for the privatization of 60 percent of shops in 1992. This will not be enough. Without productive private industry, there will be nothing to sell in these shops.

All of the programs of economic reform that the Russian government is now trying to effect are directed toward the preservation of the Russian empire and the creation of certain illusions of reform. First, an illusion of change in the system of ownership in order to induce workers to work more productively for the same salary, and second, an illusion of radical market and other democratic reforms designed to elicit massive economic assistance from the West. Russia's democratic institutions are still unstable. Contract law and liability law do not exist. Property rights, such as they are, are not enforced.

### Privatization

Russia and the newly independent states are now confronted with the urgent necessity of replacing the command system with one based on private ownership, competitive markets, entrepreneurship, and customer service. The transition from a command economy to economic freedom implies recognition of private property and private decision-making in the allocation of resources. This is now absolutely clear to everyone, except some colleagues who have yet to acknowledge the obvious source of the Soviet economic collapse. One example is Robert J. Samuelson, who writes in *Newsweek*: "What we can offer is a reform agenda and the money—not huge amounts—to make it practical." Specifically, he writes, the republics need to (1) preserve internal trade; (2) overhaul farm policies; (3) create usable money; and (4) revive oil production.<sup>14</sup>

Malia is absolutely correct when, referring to such recommendations, he writes: "To be sure, all of these discrete problems are quite real; and all of them will require technical solutions of the sort just mentioned. Nevertheless, none of them will work unless it is first realized that the post-Soviet crisis is a *total* crisis, embracing every aspect of life at once. For all basic institutions in the former Soviet Union collapsed together and at once; and thus all of them must be rebuilt together and, if not all at once, then in rapid succession."

Privatization, however, is the first step: state ownership was the main source of economic disaster, so if this problem is not addressed, any reform will inevitably fail. Privatization, however, is a rather complicated procedure. It involves much more than simply a series of administrative steps leading to the automatic transfer

<sup>10</sup>Calculated from *Narodnoye khozyaystvo SSSR v 1989 godu* (The National Economy of the USSR in 1989), Moscow, Statistika, 1990, p. 279.

<sup>11</sup>Calculated from *ibid*.

<sup>12</sup>"Rent Seeking and Profit Seeking," in James Buchanan, Robert D. Tollison, and Gordon Tullock, Eds., *Toward a Theory of the Rent-Seeking Society*, College Station, TX, Texas A & M University Press, 1980, pp. 3–15.

<sup>13</sup>Industry in Russia is run on the same basis as the US Postal Service. Let us assume that the US government gave permission to the Postal Service to charge whatever prices it wanted. Would this be a free-market reform?

<sup>14</sup>*Newsweek* (New York), Oct. 14, 1991, p. 37.

mation of unprofitable enterprises into prosperous ones. World experience has demonstrated rather clearly that privatization is first and foremost a political rather than an economic process. Many privatization programs failed because this factor was overlooked.

Today, Russia and the other post-Soviet republics are confronted with a serious dilemma. The need for major reforms in the sphere of ownership is widely recognized, even among the more rigid representatives of the bureaucratic elite. At the same time, however, there are many formerly communist Russian politicians who are trying to persuade public opinion in Russia and in the West that the majority of the population is unprepared to accept the hardships and uncertainties that will be brought about by wholesale privatization. Russian bureaucrats as well as some Western economists would insist that the population of Russia and other republics is not psychologically prepared to support large-scale privatization programs, that they "cannot understand the market," and that they "carry around the collective-command mentality rather than the trade-exchange mentality."<sup>15</sup>

The economic reality is quite the opposite—the cooperative (i.e., private) sector is growing. By 1990, the number of cooperatives reached 300,000, and employment in cooperatives has increased 25 times since 1987 with an estimated annual increase in output of 30 percent.<sup>16</sup> By 1991, more than 5 million people were employed in cooperatives that produced goods and services worth 67 billion rubles. In Russia alone, cooperative business is booming—the number of construction companies doubled in 1990.<sup>17</sup> Other evidence that the Russians "can understand the market," and that they do not "carry around the collective-command mentality rather than the trade-exchange mentality," is the fate of Russians who have emigrated to the United States and are adjusting extremely well to American society. Economically, the Russians are a true "American success story"—the average Soviet immigrant's household earned US\$5,000 more per year than did the average American household.<sup>18</sup> Admittedly, those who emigrated over the past 20 years were ambitious and well educated, and not "average" Soviet citizens by any standard. Nevertheless, their success proves that the motivation of *homo economicus* is still there for at least a certain segment of the population despite over three-quarters of a century of being brainwashed with the "socialist ideal" of equality.<sup>19</sup>

Private ownership of the means of production is not sufficient for economic success. Prices for all goods and services must be free to reflect supply and demand. Regulations, taxes, tariffs, and credit manipulation all distort the price system. They also allow bureau-

crats to retain their control over the economy. Moreover, the functions the government performed in a centrally planned economy must be abandoned completely, while new functions and responsibilities for providing (but not necessarily producing) public goods and for trying to offset the distortions caused by externalities need to be introduced. A full theoretical discussion of government activities would take us too far afield. So, we will concentrate here on the immediate steps that must be taken to ensure a positive role for the government in the transition to the market economy.

Evidence from previous cases of reform does not, however, necessarily imply that future reforms must follow the same path. We will never know what kind of growth rates and increases in living standards South Korea, for example, might have achieved had it fully liberalized trade and not subsidized select industries. Nevertheless, there are certain lessons to be learned from the experience of the newly industrialized countries. The most important one concerns the value of stability, credibility, consistency, and coherence in economic reform policy.<sup>20</sup> In Russia and the other republics, instituting a legal framework is important for legitimizing business activities as well as for ensuring the credibility of prices.

## Legal Reform

A market economy cannot function without a legal structure that is consistent with the underlying institutions of private property and freedom of contract. Any reform of the formerly socialist economy must be undertaken in concert with the institutionalization of the rule of law where the legal code is primarily directed toward defending person and property against threats from either the state or private parties. Governmental decisions must be rooted in the consent of the governed, acting through structures designed to prevent individual oppression or political tyranny. Procedures

<sup>15</sup>James M. Buchanan, "Why the Soviets Cannot Understand the Market (And Why We Cannot Understand Why They Cannot Understand)," *Journal of Private Enterprise* (Waco, TX), Fall 1991, pp. 12, 14.

<sup>16</sup>*Narodnoye khozyaystvo SSSR v 1990 godu* (The National Economy of the USSR in 1990), Moscow, Statistika, 1991.

<sup>17</sup>*Ekonomika i Zhizn'* (Moscow), No. 20, May 1991, p. 12.

<sup>18</sup>Leon Aron, "Preparing America for the Wave of Russian Immigrants," *The Heritage Foundation Background* (Washington, DC), Mar. 6, 1991, p. 14.

<sup>19</sup>Paul Craig Roberts points out that the hardships involved in the transition to the market economy should not be overestimated: if the Soviets could endure communism for 70 years, they can endure privatization. See *Moscow News*, Oct. 7–14, 1990.

<sup>20</sup>In the cases of South Korea, Singapore, and Taiwan, this implied mild measures of coordinated trade and industrial and credit policies to promote so-called infant industries.



must be subject to appraisal by an independent judiciary rendering judgments based on law.

Thus, government maintains a framework of security and order within which liberty can be enjoyed. Individual rights of person and property are treated as inalienable, as absolute standards. Governments are instituted among people so as to secure and protect those rights. Obviously, not only the Russian government but also the governments of many of the republics have a long way to go before they meet this standard. Only time will tell whether they will make it.

### Inflation and the Price Level

One of the most important objectives of the economic transition is price stabilization. All former Soviet republics are already experiencing hyperinflation. On the one hand, stable prices and a convertible currency are the bases of any healthy economy. In addition, containing inflation is a crucial condition for both economic and political stability. On the other hand, the inflation of the money supply is a rather profitable endeavor for government officials—it provides them with economic rents and makes further regulation inevitable. Gorbachev, more so than all his predecessors, used this ancient technique to fund the state machinery. The growth of the money supply averaged 10–15 billion rubles annually in 1987–90, and reached over 50 billion in 1991. Inflation will probably reach 1,100 percent in the first quarter of 1992.<sup>21</sup> Yel'tsin's government is far from resolving the issue of money and banking as well. The Russian State Bank continues to print rubles without regard to the damage it is causing. This is the main source of inflation.

What needs to be done in these conditions is obvious—remove price and wage controls and abolish subsidies. In the long run, such a policy will counter the inflationary spiral and fill the shops with goods. In the short run, this policy is likely to increase prices and reduce the real standard of living. As Murray N. Rothbard puts it:

*[S]evere price controls have disguised the price inflation, and have also created massive shortages of goods. . . . If the government went cold turkey and abolished all the controls, there would indeed be a large one-shot rise in most prices, particularly in consumer goods suffering most from the scarcity imposed by controls. . . . Total decontrol eliminates dislocations and restrictions at one fell swoop, and gives the free market the scope to release people's ener-*

*gies, increase production enormously, and direct resources away from misallocations and toward the satisfaction of consumers.*<sup>22</sup>

Further anti-inflationary policies, especially involving a program of industrial restructuring, will generate high levels of unemployment. While necessary and beneficial in the long run, these policies will no doubt be extremely unpopular. Unless pursued with vigor and along with more radical political and economic reforms, they could in fact become unacceptable and result in social calamities. An excellent example of rapid economic recovery is West Germany after World War II, when Ludwig Erhard initiated the dismantlement of the entire structure of price and wage controls on July 7, 1949.

Even the financial policy of "reformist" local governments (such as that in Moscow, headed by reformer Gavriil Popov) is characterized by a confiscatory approach to profits and personal incomes using high tax rates and severe price controls. These reformers, as Malia notes, understand that von Mises and Friedrich Hayek were right about socialism, but they fail to understand that they were also right about extensive government regulation. It is not enough to have private ownership of the means of production. Regulations, taxes, tariffs, and credit manipulation all distort the price system.

The de-nationalization of state assets, and the increasing freedom of private enterprise, will no doubt help to alleviate much of the adverse effects of the transition. Private enterprises, especially in the neglected areas of service and consumer-goods production, can absorb much of the unemployment that will inevitably result from the restructuring of heavy industries. The private sector must serve as the social-welfare safety net for the democratic regime.

Another problem of critical importance is that of unemployment insurance, which in the complete absence of any accumulated funds, must, at least for the transitional period, be covered through public provisions. Premature dismantling of the existing social safety net could lead to a situation where the reforms would be considered unacceptable and a reversal could be anticipated. But all provisions should be measured, so as not to create disincentives for the participation of all people in the social division of labor that grows out of market economy.

### The Pace of Reform

The conventional wisdom of Western Sovietology counsels going slowly, "phasing-in" freedom, rather

<sup>21</sup>Moscow News, Apr. 11, 1991; Kommersant (Moscow), Dec. 25, 1991; The Washington Times, Jan. 13, 1992.

<sup>22</sup>Murray N. Rothbard, "A Radical Prescription for the Socialist Bloc," The Free Market (Auburn, AL), March 1990, p. 3.

than taking the generally reviled path of radical and comprehensive social and economic change. Gradualism and piecemeal change are held up as a sober, practical, responsible, and compassionate path of reform, avoiding the sudden shocks, painful distortions, and unemployment brought by radical change. As is obvious from the Soviet experience, however, gradual reform provides a convenient excuse for the vested interests in the state bureaucracy to change nothing at all. Combine these interests with the standard resistance to change that is endemic to socialism, and support for change will be reduced to mere rhetoric.

Due to the urgent need to create an effective market, it is important to enact reforms as soon as possible. Gradualism should be eschewed in favor of a radical and immediate overhaul. The implementation of the required elements of reform should be done simultaneously and as fast as possible. János Kornai put it bluntly: "[T]hese measures must be taken in one stroke. . . . Most of the measures beneficial as parts of the stabilization package would be dangerous and damaging if taken singly, without the other measures being implemented at the same time."<sup>23</sup>

There is little the West can do to alleviate the post-communist economic crisis. The Russian people know how to grow grain and bake bread, but the system provides them with incentives to do neither. Russia's problems, as Malia states, are neither technical, nor natural;

rather, they are the product of the existing system. So any amount of "experts" dispatched to help the Russians fix "their food distribution system" will be of no help.

A comprehensive program of transition to the market economy should include the introduction of private property through a variety of means, the creation of stock exchanges and provisions for free trade in shares, the denationalization of land, the elimination of state price controls, the creation of labor markets through the elimination of restrictions on the freedom of labor to contract, the immediate sale of state-owned housing, the enforcement of drastic cuts in military and other government spending, the implementation of monetary reforms aimed at achieving currency convertibility in international money markets, and the liberalization of foreign trade.

The centrally planned economic system was linked to the Communist party's "leading" role in society, thus making all economic reforms impossible. As the post-communist governments of the former Soviet republics make the transition from centrally planned to market economies, they will confront strong political forces (including those in the West) that will seek to pull them in the opposite direction.

Today, one of the most important issues for Russia and other newly independent states is how can former socialist countries keep from repeating the mistakes made by the West when its own policy-makers borrowed from the utopian socialist model. Undoubtedly, Malia makes a significant contribution to our understanding of these problems.

<sup>23</sup> János Kornai, *The Road to a Free Economy*, New York, Norton, 1990, p. 159.



## Commentary

# Political Scientists and Sovietology

Dale R. Herspring

THE thought-provoking essay by Martin Malia on the collapse of communism in the Soviet Union raises a number of issues of critical interest to Soviet analysts, whatever their methodological persuasion. He is correct in arguing that the events of August 1991 represent more than a minor shift in governmental power (i.e., overcoming an attempted coup by dissatisfied conservatives who saw their world slipping away). If anything, the failed coup, as Malia suggests, led to a systemic collapse of the Soviet political system. Those who opposed the movement toward a more open, pluralistic society have been swept away. The task now is to construct a *new* political system.

Malia expresses two concerns that I believe warrant a response. First, he states that since the collapse in the USSR is *total*, it requires a total policy response on the part of the West. Second, he argues that not only was Western social science unable to predict the end of the Soviet system, it did a poor job over the years of analyzing the evolution of developments in that country.

### Western Policy

Malia is concerned that "too often" the West treats problems in the Soviet Union "as discrete and separate, as if they could be taken up and solved one at a time." As an example, he cites the often-mentioned problem of food distribution. From an analytical point of view, Malia is correct. There is a tendency to believe that if only the transportation system, or silo storage, or

the medical system could be improved, then the political systems of the successor-states would become more viable.

Unfortunately, the fact is that the political process in the United States is not supportive of such an approach. Individual bureaucracies, whether they be the Congress, the Pentagon, the State Department, or private groups such as labor, industry, or charitable organizations, tend to favor specific programs. For example, there is talk of intensified military exchanges between the US and Russian militaries, of increased academic exchanges, of assistance to Russian agriculture, etc. The point is that while it would be desirable to have all of these programs coordinated and integrated into a holistic planning process, this is not likely to happen. Should we discourage a US medical group because it wants to assist a Ukrainian city in overcoming some of the effects of pollution on children? Likewise, should exchanges between small colleges in this country and colleges in Russia be discouraged because they are not part of a larger exchange program? My own judgment is that we must deal with the reality of American politics; this is a country of individualists, and my 25 years in the US government tell me that no matter how hard we try, we will never succeed in putting together a holistic approach to aiding foreign countries. In fact, I am not sure we want to go down this path. Individualism is the basis of American democracy, and if nothing else, a piecemeal approach, involving a wide variety of programs, may go a long way to help the Russians—who have been used to a collective political system—to understand the importance of individualism and diversity.

### The Question of Theory

Malia's methodological concerns mirror those he expressed vis-à-vis the US policy approach toward the

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