Ed A. Hewett

THE NEW SOVIET PLAN

Among the many conflicts in the U.S.S.R. in the summer of 1990, none was more riveting or important than the clash between Mikhail Gorbachev and Boris Yeltsin, the chairman of the parliament of the Russian Soviet Federated Socialist Republic (R.S.F.S.R.). Since last May Yeltsin has been on the attack, accusing Gorbachev of dragging his feet on the introduction of market reforms and of denying Russia its sovereignty. The demand for sovereignty has been popular among Russians convinced that their lives would improve dramatically if they could only liberate their republic's resources from the hands of Moscow bureaucrats. For other republics it was an immense boost to have Russia—the core of the U.S.S.R. and Gorbachev's power base—join their side in their battles with the central government. The call for a rapid move toward a market economy also found enormous resonance in a population frightened by the combination of a chaotic economy and a government helpless in the face of the decline of the Soviet Union.

For Gorbachev, skilled politician that he is, Yeltsin's approach and its appeal could hardly have come as a surprise. The Soviet president must have watched with a tinge of envy as his old rival used his advantage as a leader of the opposition to insist that the problems were easier to confront than the leadership supposed and, in particular, that introducing a market economy need not be painful if only it were handled well.

II

Yeltsin's message was welcome news to a population already feeling pain long before the government got around to considering a market system. As 1990 unfolded the Soviet economy was sliding downward, with no realistic prospect of a

---

Ed A. Hewett is a Senior Fellow in Foreign Policy Studies at The Brookings Institution in Washington, D.C. He is also editor of the journal *Soviet Economy* and Chairman of the National Council for Soviet and East European Research.

reversal. Official statistics in the spring were already showing a fall of between one and two percent of GNP, and a realistic adjustment for inflation would have yielded an even greater decline. Inflationary pressures were building as the government printed rubles at record rates to accommodate a deficit equal to between five and six percent of GNP and to allow wages to grow at about nine percent per annum—although labor productivity was actually falling. Consumer savings began to swell as the growth in wages far outpaced real output. The government estimated that consumers held approximately 165 billion rubles (equal to about a half-year's consumption expenditures) in "hot" money—so called because consumers were likely to spend it quickly whenever goods appeared. Finally, sheer governmental mismanagement, compounded by the oil-price shock that began in August, left the Soviet Union several billion dollars in arrears on suppliers' credits, leading to a dramatic plunge in the Soviet credit rating in international financial markets.

Prime Minister Nikolai Ryzhkov's government tried to respond, submitting to the Supreme Soviet in May a plan for introducing a market economy. As an economic document this was a major improvement over previous efforts. It recognized the need to create a market economy, and the approach it proposed made sense in many ways. But it was vague on how quickly a market economy would emerge and, in particular, on how property rights would be handled under the new system. As a political document, however, it was a disaster because it led off with a bone-crunching austerity program built around a massive increase in consumer prices. To be sure, the government promised compensation for the price increases and indexation of future incomes. But the population was in no mood to trust the Ryzhkov government, given its previous track record; accordingly, the Supreme Soviet sent the prime minister back to the drawing board with orders to come up with a better plan by September 1990.

In most countries the government would have fallen with the rejection of its plan. But in the U.S.S.R. today, it remains Gorbachev's decision whether to replace a government. For whatever reason, he chose to hold on to Ryzhkov. As the summer wore on, disintegration of the party and the centralized union accelerated. The government began to lose control over the situation.

This provided an ideal platform on which Yeltsin could stand tall, promising to bring order from chaos by installing a market economy in 500 days, and at the same time to give substance to the hitherto empty concept of a "union of sovereign republics." Yeltsin was still essentially powerless, but he was hugely popular and had political momentum—and not only in Russia. Gorbachev, on the other hand, enormously powerful on paper and triumphant on the international stage, was increasingly unpopular at home and was losing momentum, even in Russia.

Under these circumstances Gorbachev moved in late July to cut a deal with Yeltsin. On August 2 he announced the formation of a working group of 13 members, including both his and Yeltsin's top advisers, charged with combining the Ryzhkov and Yeltsin plans into a common strategy for introducing a market economy as the foundation for a new Treaty of Union (to replace the previous treaty, which dated from 1922).[1] What came to be called the Shatalin Working Group (after its chairman, Stanislav Shatalin, the only economist on Gorbachev's presidential council) was given one month to complete its work, with the intention that this group's report, and not the Ryzhkov government's revised plan, would be what would go to the Supreme Soviet the first week in September.

The Shatalin Working Group complied with the timetable, and—as best they could—with the mandate. They presented Gorbachev and Yeltsin with a plan to create a market economy and an economic union in the U.S.S.R. in 500 days; the proposal also included much of what made sense in the government's plan.[2] They proposed to present this plan both to the U.S.S.R. Supreme Soviet and to the supreme soviet of each republic, in the hope that all would approve it by late September, enabling the 500 days to run from October 1990 to March 1992.

Despite Gorbachev's clear directive, the Ryzhkov government cooperated only reluctantly and partially with the Shatalin Working Group. Indeed, Leonid Abalkin, Ryzhkov's dep-

[1] The original composition of the working group included Stanislav Shatalin (its chairman) and Nikolai Petrakov, both economic advisers to Gorbachev; Leonid Abalkin, the U.S.S.R. deputy prime minister in charge of economic reform; Grigory Yavlinsky, the R.S.F.S.R. deputy prime minister in charge of economic reform; Boris Fedorov, the bright young minister of finance for Russia; and a group of mostly young academic specialists.

[2] *Perekhod k rynku* (Transition to the Market), 2 vols., Moscow, "Arkhangel'skoe," August 1990. Volume I contains the program, volume II drafts of selected legislative acts. All references here are from volume I.

uty prime minister in charge of economic reform and the only direct link between Ryzhkov and the Shatalin Working Group, dropped out early in August. The Ryzhkov government came back to the Supreme Soviet on September 1 with merely a revised version of its May plan, while the Shatalin Working Group—essentially converted into a task force for elaborating Yeltsin's 500-Day Plan—presented a very clear and radical alternative.

III

While the two plans shared much in their details, there were several large issues on which they fundamentally disagreed. The Shatalin Plan began by reconstituting the U.S.S.R. as a confederation, which would then grant powers to the center. The Ryzhkov Plan retained powers in the center, but granted increased power to the republics.

The two plans also disagreed on sequencing and timing. The Shatalin Plan would have deferred consumer price increases, beginning instead with such measures as a quick sale of state assets to build popular support for the program. The Ryzhkov Plan, on the other hand, would still have led off with price increases, albeit less severe than those proposed in May, and with full monetary compensation to the population. Finally, the authors of the Shatalin Plan called for a rapid dismantling of the government apparatus and "destatization" of assets, while the Ryzhkov Plan (written by the government apparatus) would have moved more slowly on both counts.

Gorbachev was unwilling to endorse either plan. His closest economic advisers—Shatalin and Nikolai Petrakov—were authors of the 500-Day Plan, and clearly Gorbachev was drawn to many parts of the scheme. But the most obvious problem for Gorbachev was the federalizing plank, whereby the U.S.S.R. would be converted into a confederation. Moreover, Gorbachev persisted in supporting Ryzhkov, and his preference for the middle ground led him to ask economist Abel Aganbegian in early September to develop a compromise. In a very few days Aganbegian came up with a new document that was basically the Shatalin Plan, but which contained a healthy dose of "blue smoke and mirrors," particularly in its proposals for the structure of authority in the new federation.

By mid-September the parliament of the Russian Republic endorsed the Shatalin Plan, basically on principle, since they hardly had time to digest all 222 pages. The Soviet (all-union) parliament, on the other hand, had by then only just received the three documents they were being asked to consider: the Shatalin Plan, the Ryzhkov (formally, the Council of Ministers) Plan, and Aganbegian's rewrite of the Shatalin Plan. Even Aganbegian's plan, however, failed to receive Gorbachev's explicit support, and the all-union Supreme Soviet recommended that the president ask yet another group to combine the three plans into one, and report back to it on October 15. In the meantime Gorbachev asked for and received special powers to issue decrees necessary to stabilize the economy and move to a market. Not coincidentally, these powers are valid through March 1992, approximately 500 days later.

On October 16, Gorbachev came back to the Soviet parliament with a "Presidential Plan," which he fully supported. This plan, again authored by Aganbegian, retains the basic elements of Aganbegian's earlier draft, and therefore of the Shatalin Plan. But the Presidential Plan is one-third the length of the Shatalin Plan, leaving out virtually all specifics on key points, and eschewing a day-by-day timetable. For example, it drops any mention of 500 days, but retains the four stages of the original Shatalin Plan. It is therefore not so much a plan as it is a statement of intent so general as to be unobjectionable to the various factions in the debate. It easily passed the Supreme Soviet on October 19—with the proviso that the legislators might wish to modify it later—and it was to go into operation on November 1.

At the same time, Gorbachev continued to issue presidential decrees, many of which are not dissimilar to those called for in the first 100 days of the Shatalin Plan—the difference being that the decrees are coming out in absence of an agreement with the republics. Indeed, Russia has announced its intention to go ahead with the 500-Day Plan, which is likely to mean considerable tension with the union. Other republics, while they may not follow the 500-Day Plan, will also tend to go their own ways.

While the Shatalin Plan seems, for the present, to have been shoved into the background, there are good reasons to believe that its significance will nevertheless loom large in the coming months. The fact that the plan was too radical to win approval this fall means little. Given the rapidly deteriorating economic and political situation of the U.S.S.R., this month's unacceptably radical proposal can be next month's conventional wisdom. Moreover the unique strength of the Shatalin Plan, among all the plans under discussion, lies in its serious attempt to come to grips with current political and economic realities; it assumes the union is breaking apart and seeks to construct a viable economic logic to reconstruct it.

Over the next years as the centrifugal forces grow still stronger and the economic crisis deepens, it is the Shatalin Plan that offers the only feasible approach to controlling the disintegration and reversing the economic decline. To understand this plan is to understand the dilemma the Soviets now face, and its possible resolution.

IV

The origins of the Shatalin Plan lie in a 400-day model drawn up last February in Deputy Prime Minister Abalkin's office by Grigory Yavlinsky and several of his associates. It was designed to guide Gorbachev in using proposed strong presidential powers to stabilize the economy quickly and introduce a market economy, all by decree. Although Gorbachev did, in fact, win his new presidential powers in March, he ignored the plan, relying instead on the Ryzhkov government (essentially Gosplan, the state planning agency) to implement reforms. The plan lay dormant until the spring, when Mikhail Bocharov, a contender against Yeltsin for the chairmanship of the R.S.F.S.R. Supreme Soviet, modified and expanded it into a 500-Day Plan. Upon assuming his new post, Yeltsin adopted the plan as his own, and Yavlinsky left Abalkin's office to join the Russian government as a deputy prime minister and chairman of the R.S.F.S.R. State Commission on Economic Reform (the counterpart to Abalkin's post at the union level).

In August Yavlinsky and his co-authors joined the Shatalin Working Group, along with Evgeny Yasin, Abalkin's most senior and best economist. They brought with them the 400-Day Plan, the proposed 500-Day Plan, and other programs they had developed while working for Abalkin that had been rejected as too radical. Under the leadership of Shatalin, Nikolai Petrakov (Gorbachev's personal economic adviser) and Yavlinsky, the group set out to weave these disparate threads together into a plan for creating an economic union and moving to a market economy in 500 days.

The result is an exciting document, infused with a spirit of liberation from the dogmas of the past and from the bureaucracy that has used those dogmas to retain its oppressive hold over the lives of Soviet citizens. The word socialism never appears; Karl Marx does not even linger in the background. The authors of the plan are pragmatists seeking to create—in less than two years—a market, or what they sometimes call a "normal," economy. Most prices would be determined by supply and demand; enterprises would be primarily in private hands (or at least under the control of the stockholders, only one of which would be a disinterested state "owner"); the ruble would be fully convertible, and the economy would be oriented to meet consumer needs, not those of the military or the bureaucracy.

But the Shatalin group members were pragmatists working against a one-month deadline, faced with a bureaucracy reluctant to give them the necessary data or help. The result, for all its boldness, is a hastily prepared, internally inconsistent and sometimes vague document supported by only very sketchy quantitative analysis. On some key issues—for example the rate at which privatization will occur—different parts of the plan offer dramatically different scenarios. The answers to other concerns—the likely magnitude of a decline in economic activity or real living standards, for instance—are either not given or are only implied. This document deserves to be analyzed, however, because the Presidential Plan that was adopted by the Supreme Soviet in October still follows the main line of the Shatalin Plan, albeit at a slower and more conservative pace.

V

In Stage One, the first hundred days, of the 500-Day Plan the Soviet Union would be reconstituted as a voluntary economic union, much along the lines of the European Community.[3] The 15 sovereign republics would hold all power in the system, governing through an Inter-republican Economic Committee (IEC), which would supervise the remaining, and much diminished, central bureaucracy. The chairman of that IEC, separate from the president of the U.S.S.R., would wield considerable power. The center would serve the republics, enjoying only the powers granted to it. Each of the republics would control the introduction and operation of the market economy within its borders; each could move at a somewhat

[3] Republics not prepared to join the union could apply for "associate" or "observer" status. I will assume here, for purposes of exposition, that all 15 would join.

different pace, although large disparities would cause difficulties.

The plan calls for a unified all-union market, with no internal barriers to trade, and a single tariff system surrounding the entire country. The unified market would require a single currency and a single central bank, the "Reserve System," modeled after the U.S. Federal Reserve and enjoying independence from the central and republican governments. The Reserve System would be managed by a chairman and assistants appointed by the Soviet president, and by a board composed of those appointees and the heads of the central bank of each of the 15 republics. Macroeconomic stability would be preserved by a firm rule that the central and republican governments could not (with minor exceptions) finance deficits through the bank, but only through bond sales to the population.

Republics would delegate to the central government responsibility for national defense, internal security, the regulation of prices for key products, environmental policy and other responsibilities that the republics agree should be managed at a national level. Because republics and local authorities would hold all taxing power, finances for central government activities would be gathered either through contributions from the republics (according to a formula negotiated among them) or—more probably at the beginning—through the granting of specifically delimited taxing powers to the center (for example, a turnover tax or a profits tax).

All foreign exchange would flow either to the republics (for example, receipts from the export of raw materials and fuels, which would be recognized as republican property), or to enterprises within the republics. These enterprises would be required to sell some of their foreign exchange for rubles at the prevailing exchange rate. The republics would then retain some of that foreign exchange, dividing the remainder between contributions to local authorities and a central fund for servicing the Soviet debt.

The plan leaves much unsaid regarding procedures for reaching and enforcing agreements among the 15 republics. It suggests, for example, that contributions by the republics to the central budget could be made either on the basis of relative level of GNP, or on GNP per capita, without belaboring the obvious point that using the per capita formula would cost the rich republics much more than the total GNP formula.

Also, it is clear that this constitutional component of the plan—which the Shatalin Working Group developed in close consultation with representatives of virtually all of the republics—is not fully integrated with the remainder of the document. Many chapters of the plan discuss in detail what economic policy should be without even a passing mention of the fact that such policy could be instituted only after long, presumably heated, debates in the IEC. There is a very clear sense in this document that the economists on the Shatalin Working Group were able or willing to absorb only partially the logic of an economic union in their plans for the introduction and operation of a market economy in the Soviet Union.

VI

The first stage of the Shatalin Plan would also feature a set of quickly executed measures designed to win the confidence of the population by a clean break with the past, combined with an all-out effort to use existing resources to expand the supply of goods while retaining controls over prices and over much economic activity. Then, having done all it could with existing resources, the leadership would turn to the people to ask for patience and some sacrifice during the remainder of the implementation period.

The break with the past would start on Day One, with the Soviet president and the heads of the republics issuing decrees declaring equal rights for all individuals in all forms of economic activity, announcing guarantees of property rights to individuals and eliminating laws punishing entrepreneurial activity. A general amnesty would be given to those arrested in the past for economic crimes that would no longer be illegal in the new system.

Some elements of the past would be temporarily retained in order to preserve a modicum of stability. Prices would remain frozen throughout the first stage. Enterprises would be required to fulfill state orders (a device introduced several years ago to replace obligatory plan targets) but they could negotiate prices with the Union Contractual System, the all-union body issuing the orders. Moreover, the magnitude of state orders would probably be lower than under the old system. Although price liberalization would begin after the first phase, state orders would be retained until about halfway through the program, in order to retain some semblance of stability during the early, and most tumultuous, phases of the transition.

There would be a quick sell-off of various state assets: a portion of the state-held fleet of autos and trucks; unfinished construction projects, uninstalled equipment and construction materials; various civilian products (e.g., automobiles) now in the hands of the military; and assets, now held by "social organizations" and other party organizations, that were acquired with state funds. These moves would have the triple advantage of establishing the new system's concern for consumer welfare, of launching the process of privatization immediately and, at the same time, of soaking up some of the 165 billion rubles in "hot" money.

The Reserve System would be up and running within the first two weeks, and within several months the existing specialized state banks (for industry, agriculture, and so forth) would be converted into joint-stock commercial banks. The Reserve System would freeze the money supply in an effort to squeeze out inflation. This, plus a cutoff in subsidies to state enterprises, would put pressure on all enterprises to improve efficiency.

In Stage One the government would balance the budget by cutting various expenditure categories: a twenty percent cut in KGB expenditures, a ten percent cut in defense (from which a third of the savings would be used to increase salaries for military officers and housing allowances for decommissioned soldiers), a reduction of approximately 15 percent in centrally financed state capital expenditures, and a cutoff in all subsidies to state enterprises.[4] Had these measures been implemented for the fourth quarter of 1990, as originally scheduled, the Shatalin Working Group estimates that the budget would have staged a turnaround, from a projected 15-billion-ruble deficit that quarter to a surplus of four billion rubles. A freeze would be put in place on new budget programs costing over 100 million rubles, save for programs associated with the cleanup of the Chernobyl nuclear accident site.

During the first stage a multitude of measures would be applied in an effort to stabilize the consumer goods market. The government would move to expand the supply of consumer goods through the asset sales mentioned earlier, and through sales of consumer goods imported with Western assistance. The central government would also sell to the

[4] These are all cuts for one quarter, and would be less for the year as a whole.

population what I estimate to be $1.5 billion, or approximately ten percent, of its dollar holdings, and $400 million, or about one percent, of its gold bullion reserves, receiving in return 12 billion rubles. Quick sales of one percent of the housing stock would bring in five billion rubles during that first hundred days.

These asset sales would continue throughout the four stages of implementation, eventually totaling 143 billion rubles. These measures alone could potentially put a major damper on excess demand, although how much depends on how confident Soviets are that the stabilization program will succeed. Soviet citizens have about 500 billion rubles in cash and savings, and all of that would become "hot" if they became convinced that hyperinflation were imminent, in which case they would become desperate to exchange their cash for goods.

VII

In addition to these quick sales of assets, the cornerstone of the Shatalin Plan is a call for the government to get started immediately on the "destatization" and privatization of productive assets. "Destatization" (*razgosudarstvlenie* in Russian) is a very special term that is important to understand in order to avoid confusing it with denationalization. It means, literally, taking the assets out of the hands of the state (read "bureaucrats"), but it does not automatically imply selling or giving those assets to private persons. The assets, for example, could be leased out for a fixed fee; they could be sold to employees or given out on a lease-to-buy basis, or they could simply be transferred to a state-established holding company that would act as an independent owner/investor. Privatization, by sale or auction to private individuals, might then occur either immediately or somewhat later.

The plan stipulates that within the first two weeks the U.S.S.R. Fund for State Property (which was created this summer to manage assets transferred from branch ministries) and its republican counterparts would agree on who would be responsible for destatizing portions of the state's assets, which have a book value of 2.6 trillion rubles. The center would retain control over several categories of assets: defense contractors; producers in the nuclear power industry; the pipeline, railroad, postal, telegraph and unified energy systems, and all military facilities.

A second set of industries—instrument makers, communications-equipment manufacturers, electronics, shipbuilding and other national but nonstrategic industries—would be converted into transrepublican joint-stock companies, whose stock would be distributed among the republics.

Republics and local authorities would divide responsibility for destatizing the remainder of productive assets. In the first stage priority would be given to rapid destatization or privatization of enterprises in the construction and construction-materials industries, auto transport, services, trade, light industry and food processing. The plan recommends total privatization of all small retail outlets and restaurants, if not in the first stage, then shortly thereafter.

It would also be during the first phase that republican and local authorities would begin a massive land reform, along with a privatization of farming and farm-related services. The goal is to reconstitute some of the 60,000 state and collective farms into private or cooperative farms, while breaking up others to free land for the creation of 150,000–180,000 small farms. These farms would be free to grow or raise what they wished, and could sell their products at market prices. This new freedom, combined with a privatization in the transportation and food-processing industries, will lead to a rapid improvement in the quantity and quality of food available to the population—or so the Shatalin Working Group hopes.

The working group recognizes that destatization and eventual privatization of the huge state enterprises will take considerable time to implement, although different portions of the report vary greatly on just how much time. Particularly at the beginning, when there is no experience in this area, no capital markets and a price system in disarray, it would be risky to force the pace of destatization.

The report emphasizes investment funds as a transitional form of ownership, useful in beginning the process of converting to joint-stock companies. State enterprises slated for destatization through conversion to joint-stock companies would be given a book value, for which a packet of stocks would be issued and then passed on to the appropriate investment fund. These funds would act as owners (without participating in the daily operations of the enterprises), and receive dividends, which would be passed on to the budget of the union, republican or local government that created the fund. Over time the investment funds would dispose of their stock through sales to the population, to workers of the enterprises involved (up to ten percent of the stock can go to them at a discount) and to foreigners. Most of the proceeds from the sales would simply be taken out of circulation as part of the effort to soak up "hot" money.

There is no effort in the report to estimate the potential value of productive assets sold over the 500-day period, but some magnitudes are discussed. Selling off small retail outlets might raise four billion rubles early on. More significant sums would come from selling off the large enterprises. Here, the authors of the Shatalin Plan offer the suggestive calculation that the population could more or less immediately purchase something in the range of 100–150 billion rubles of assets out of cash holdings (mostly stocks), and another 50–60 billion rubles per year for the first two years out of new savings. That would add up to sales of something approaching ten percent of the two-trillion-ruble depreciated value of all capital in the U.S.S.R. over the 500 days.

The arithmetic is clear enough. But the timing would require the instantaneous resolution of all the disputes now raging among various government bodies at all levels over who owns what in the U.S.S.R.—and such concord seems highly improbable. Moreover, it is unlikely that the population will purchase significant amounts of assets early on, before they are fairly confident that the new economic environment has truly changed, and changed irreversibly in a direction favoring private initiative and enterprise. That, also, will likely take a lot longer than 100 days.

In short, the Shatalin Plan outlines a two-speed approach to privatization. Small enterprises would be sold immediately in a straightforward privatization that would not amount to much in rubles, but would signal a total departure from past practice. Most of the large enterprises now controlled from the Moscow ministries (with the exception of those slated to stay under central control, such as defense plants) would be immediately shifted to state holding companies ("destatized"). Then over an unspecified period extending over years, these enterprises would gradually be sold to individuals, either directly or, more generally, through stock sales. The final result, easily a decade away, would be a mixed economy, probably with a considerably larger state sector than is typical of Western Europe.

VIII

During Stage Two—from Day 100 to Day 250—the pace of destatization and privatization would accelerate, very tight monetary and fiscal policies would continue and the first moves toward price liberalization would be taken. Price liberalization would result in an increase in the price level, leading to pressures for some compensation from those segments of the population that are well organized, or well placed to strike. Layoffs would accelerate, throwing people into the newly created unemployment and retraining system.

The Reserve System would continue to freeze the money supply during this period, and output would fall in many sectors. The national and regional governments would move to balance budgets by continued expenditure cuts, but even more by increasing taxes and finding other new revenue sources. Most notably, dividend income from joint-stock companies is projected to provide an additional 60 billion rubles per year (out of total annual budgetary receipts in the range of 610 billion-677 billion rubles); social insurance rates would be dramatically increased, bringing in an additional 125 billion rubles per year in new revenue, and turnover tax receipts would rise, approximately canceling out the drop in profits tax receipts as enterprise profits fall.

Many enterprises will be forced to cut output under the pressure of falling demand. Those enterprises in the greatest economic difficulty would be targeted for sale, as the destatization and privatization processes accelerated. At the end of Stage Two, between 1,000 and 1,500 state enterprises would be operating as joint-stock companies under investment funds, and approximately half of all small retail outlets would be in private hands.

The liberalization of price controls would be one of the key components of this stage, and the design of these measures will play a critical role in determining the success of the program. For that reason it is unfortunate that the plans for price reform are rather conservative, at times out of step with the radical tone of the remainder of the program. From Stage Two onward, most wholesale prices for manufactured goods would be freely negotiated between buyer and seller, with two exceptions: markets where one or a few producers dominate would be state controlled, and goods produced under state order would be negotiated with central authorities, and could even be imposed by them if no agreement were reached.

Prices of the most important raw materials and fuels, which generally move in inter-republican trade, would be negotiated among the republics, and then administered by union authorities, who would adjust prices over time as costs change. Surprisingly, there is no indication in the plan that these prices should approximate world prices for similar products. This is a dangerous omission, for if prices for these critical commodities differ significantly from world prices, the entire price system will be distorted, leading inevitably to a multiplicity of restrictions on economic activity and foreign trade, in direct contradiction to the spirit of the entire Shatalin Plan.

Retail prices constitute one of the most sensitive areas. The Ryzhkov Plan failed before the Supreme Soviet in May because of its intention to raise consumer prices, and Yeltsin promised that his plan would be different. The Shatalin program calls for liberalizing retail prices gradually after Stage One, except for a group of approximately 100–150 products whose prices would continue to enjoy subsidization throughout the 500 days. Precisely which products are involved is not clear. The plan does state that toward the end of the 500 days, between seventy and eighty percent of consumer goods should be selling at free prices, and that at the conclusion of the 500 days only a few necessary consumer goods will be sold at controlled prices (some types of bread, meat, milk, cooking oil, sugar, basic medications, school texts, transport fares and selected consumer services).

Each republic will design the subsidy system for its jurisdiction, the general policy being to subsidize over-the-counter goods directly at the retail outlet. This, it is hoped, will be a major improvement over the existing system, which subsidizes at the wholesale level, allowing black marketeers to take subsidized goods and resell them for huge profits. Nevertheless, it will still be a very difficult matter actually to confirm sales over the counter, as opposed to under it, since the rewards of black market sales will be high for those willing to falsify sales data.

IX

These price controls are an important component of the Shatalin Plan's attempt to win popular support for a quick move to the market. The program offers extensive promises to protect living standards. In addition to controls on consumer prices, the second 150 days would see the introduction of partial indexation of incomes, in order to compensate consumers for whatever inflation did occur. But it is not clear precisely what form this indexation would take, and whose income would be covered. Nor does the plan estimate the total costs of a system of indexation.

Republican and local authorities would be in charge of indexation, and would finance it wherever state money was involved. Indexation would be based on a special consumer price index for nondurable goods. Enterprises would be ordered to increase wages by some portion of the increase in the index, financing the increase out of their own funds if profits permitted. If profits did not permit this, the state would have to pay. This provision appears to apply to all enterprises, including those privately owned, but the report does not comment on the possibility that the state might end up subsidizing unprofitable private firms in order to index wages of their employees. Republican and local governments are to pay directly to subsidize pensioners, students, other state dependents and government employees.

A minimum wage would provide yet another pillar to this strong safety net. Based on a calculation of a minimum cost of living, and differentiated according to skill levels and difficulties in working conditions, this wage would be phased in over the 500 days as an obligatory floor for wages in all enterprises. Presumably enterprises that could not afford to hire at the minimum wage would go under.

The Shatalin Working Group claims that the joint effect of these price controls and indexation would be to ensure that living standards would first stabilize, and then rise. In real terms (that is, in terms of the goods the population can actually acquire) that may be true, but it is also clear from the few data provided in the report that prices would rise, possibly dramatically, relative to incomes, and therefore that *measured* real incomes would fall.[5]

For 1991 (the bulk of the last 400 days), the Shatalin Working Group outlines three possible scenarios for incomes

[5] "Measured" real incomes are nominal incomes (not adjusted for inflation) divided by prices. In an economy where prices are fixed and goods are scarce, incomes divided by prices do not measure actual living standards. If prices rise, and more goods become available, measured living standards will fall, while actual living standards rise.

and prices. Under the two best scenarios (in terms of inflation), prices would rise 55 percent over the year, yet there is no mention of indexation in incomes, and measured real incomes are predicted to fall between 12–13 percent. It is only in the third scenario, under which inflation would notch up to 90 percent for the year (because asset sales would be going so slowly that excess demand would keep pressure on markets) that compensation would be paid. But it is only a partial payment, and real measured income in this scenario is forecast to fall by 25 percent over the year.

This decline in measured real income makes sense from the economic point of view, and is one strong point of the program that has received no public attention—for the plan's rhetoric has obscured it. Of course, from a political standpoint, it is understandable that the authors of the plan are not eager to advertise this particular feature.

Finally, during this second 150-day stage, the economy would rapidly begin to open trade with, and to receive investment from, the rest of the global economy. The ruble would be made convertible on the current account, and even (if the plan is to be believed) on the capital account. Its exchange rate would be determined in foreign exchange markets where 10–15 commercial banks would enjoy full rights to buy and sell foreign exchange. Since most foreign exchange would be in the hands either of republican and local authorities or of enterprises, the supply side of the market would rest on fairly broad foundations. On the demand side, because stringent monetary and budget policies are being counted on to keep down demand for foreign exchange, the plan foresees a fairly stable market in the range of five to eight rubles per dollar.[6] In addition, the Reserve System, which would oversee foreign exchange markets, could at times buy and sell foreign exchange in order to stabilize the exchange rate.

The general thrust of the new regulations in foreign economic relations would be to foster the rapid integration of the Soviet economy into the world economy, encouraging existing enterprises to export, and foreign enterprises to invest in the Soviet economy. But as long as price controls remain in effect for a significant group of products, and shortages remain,

[6] The recently devalued official rate is currently about two rubles to the dollar; the noncommercial (tourist) rate, about six rubles to the dollar; and the black-market rate, 15 rubles to the dollar and up.

controls on exports, imports and direct foreign investment would be inevitable.

X

Stage Three, Days 250 through 400, should in many ways repeat the previous stage, the major difference being that months of tight money policy would begin to take a serious toll on business—leading to unemployment, especially in areas such as primary products, heavy machinery and construction. Price liberalization would accelerate during this period, as would the selling off of assets. By the end of this stage, the plan calls for the destatization or privatization of between thirty and forty percent of industry, of up to fifty percent of construction, and at least sixty percent of retail trade, food and services.

Unemployment would be the most important feature of this period, rising from an estimated six million on Day One (3.7 percent of the labor force), to eight million (4.8 percent) at the halfway point, to 11.6 million (seven percent) toward the end of the transition period. To cope with what for Soviet society would be a potentially traumatic rise in job insecurity and unemployment, the Shatalin Plan outlines a generous unemployment scheme in which enterprises must provide two to three months' notice to local authorities and workers before a layoff, and must pay one month's severance pay. The local employment office would then provide assistance to laid-off workers in finding further employment, and for the first 18 months of unemployment would provide benefits that could be something like the following: seventy percent of the last wage for the first three months; then sixty percent for the next three; and finally fifty percent for 12 months. If a worker still could find no job at the end of this 19 months of support, he or she would go on welfare.

All of these benefits would be financed and administered locally, but according to norms set at the republican level, and coordinated among all the republics. The plan forecasts that toward the end of the 500 days, unemployment benefits could amount to 2.7 billion-3.3 billion rubles per month, about 5–5.5 percent of budget expenditures for the republics and the center combined.

The plan forecasts the beginning of an economic boom during its last stage, the remaining 100 days. The stabilization should have been sufficient to wring out most of the excess demand, permitting the Reserve System to allow interest rates to fall, leading to a recovery in investment. The supply-side effects of the increasing competition among the various new entrants into the market should be filling the shelves with goods.

By Day 500, if all goes as planned, three-quarters of Soviet industry would be operating generally without subsidies, in a competitive environment, managed by bodies independent of any direct state supervision, or directly by private individuals. Eighty to ninety percent of construction, auto transport, trade, food and other services would be in mostly private hands. The bulk of retail prices would move freely in response to supply and demand, as would the interest and exchange rates.

In short, the Soviet Union would have a market economy. It would be rudimentary by standards of the United States or Western Europe, but it would work. Most important, institutions would be sufficiently in place to allow the further development over the following years of a truly complex and rich set of market institutions.

XI

It is easy to pick apart the 500-Day Plan on any number of grounds. Obviously the goals outlined here would take many multiples of 500 days to realize under even the best of circumstances. And the next few years in the U.S.S.R. will hardly constitute the best of circumstances.

The published quantitative analysis underlying the document is so sketchy that it is difficult even to judge how overly ambitious the plan is. To take just one example, the few tables published do not include any estimates of the course of economic activity over the 500 days, yet many of the most critical variables depend directly on that: the rate of unemployment, the level of subsidies and the size of government receipts, to name just three.

Moreover, the plan was so hastily assembled that it is riddled with inconsistencies and ambiguities, which would have to be reconciled before implementation began. For example, the nature of destatization remains ill defined, and the pace of privatization is not at all clear. Judging from recent East European experience, it would be a miracle if, over the course of a mere one and one-half years, the new Soviet government managed to reach the goals for destatization it has set for Day 500—seventy percent of industry, ninety percent of trade and construction, and so forth. And yet, falling short there means falling short on the targets for asset sales, which will allow excess demand to spill over into the markets for goods, leading to high inflation rates.

Furthermore, while the authors of the plan clearly understand the enormous importance of maintaining fiscal balance, in fact the plan hardly inspires confidence that this important goal will be met. It is fine to say, for example, that the Reserve System will refuse to lend to the union or republican banks. But is it realistic to suggest that the Reserve Bank will have the clout to refuse Yeltsin or his bank when they need short-term finance and the bond markets are not buying?

Nor does the plan leave much maneuvering room for politicians when the going gets tough. Yeltsin seemed to promise a virtually painless transition to a market. But come Stage Two, when inflation rates are in the range of five to eight percent a month, the pressure for full indexation will be enormous, and both Yeltsin and Gorbachev will have to be extraordinary politicians indeed to resist these enormous pressures, waiting patiently for tight money to squeeze inflation out of the system.

XII

The Presidential Plan approved on October 19 is, on the surface, an improvement over the Shatalin Plan, because it seems to make allowances for some of the latter's weaknesses. Although the Presidential Plan retains the four phases of the Shatalin Plan, it drops the numbers of days, and hence the explicit promise of lightning-fast results. Destatization and privatization are to proceed at a slower pace, which implies that "hot" money will remain so for some time. In light of that, the Presidential Plan foresees a longer period of controlled prices, in an effort to avoid a price explosion. Finally, the Presidential Plan extends the period over which subsidies will be withdrawn, so as to give enterprises more time to adjust.

These are a few examples in which the Presidential Plan weakens the Shatalin Plan in ways that it might have been changed anyway. One could argue, therefore, that the Presidential Plan is a politically pragmatic restatement of the Shatalin Plan, providing Gorbachev with much-needed room for maneuver. Following this reasoning, one could imagine that the next 500 days will go as well as Shatalin and his colleagues could hope, as Gorbachev uses his power of decree to establish the market system as quickly as it is feasible to do so.

However, to hope for such a felicitous outcome would be to ignore political realities in the U.S.S.R. today. The Soviet population is weary of a leadership seemingly helpless in the face of a deteriorating economy; republican leaders find it not only politically profitable but imperative to fight for their sovereignty in an attempt to abandon what appears to them to be a sinking ship.

The Shatalin Plan begins with an all-out effort to restore confidence in the union's leadership, first by reconstituting the union, then presumably by bringing new faces into government, and finally by using the first 100 days to do everything possible to prepare the population for the inevitable pain of the transition. In that situation Gorbachev would be issuing decrees on behalf of a new government that drew its legitimacy from its clear commitment to a new beginning, and from direct support of the union's constituent republics.

Unlike the Shatalin Plan, the Presidential Plan denies this political reality. It relies on the current government to implement new presidential decrees, which will hardly inspire confidence among a population convinced that it is this government that has brought the economy to a crisis. The Presidential Plan proposes to go ahead without the support of the republics, which guarantees conflict not only over particular decrees, but over the legitimacy of all presidential decrees.

All of this suggests that the next few months will be much like the last few: enormous confusion and contention while economic decline and political disintegration intensify. Enterprises will be ordered to fulfill plans (or state orders, as they are now called) and fined when they do not do so, but to no avail. The population, convinced that the leadership is giving them more of the same old policies, will increase its efforts to hoard, and inflation will accelerate. The government will offer to sell off or lease assets, but in the uncertain economic environment it will find few buyers. Republics and even cities will respond to the crisis by seeking to hold onto the scarce products they produce, increasing the fragmentation of the economy. As the economy deteriorates, the government will respond with more decrees. Within months attention will turn to the search for yet another plan.

That plan will most likely be some version of the Shatalin Plan, or at least the framework that plan outlines. If the union is ever to be viable as an economic whole, it will only be after the republics have voluntarily joined to form a new entity, governed by a center enjoying the support of the republics and their populations. The Shatalin Plan, for all its failings, seems like the most plausible strategy for transforming the U.S.S.R.

Even the Shatalin Plan, however, may prove to be unworkable, at least in the near term. That plan is a valiant effort to reconstruct the union virtually out of whole cloth, on the basis of economic interests, rather than fear. But years of suppressed anger over nationality issues, combined with the natural instinct of each republic and city to protect itself against the chaos of the system as a whole, may give such force to separatism that there remains little support for even a loose economic union. That is not likely to be the long-term outcome; years of central planning have bound the union republics together in intricate ways that they are only now discovering. They will need each other's markets if they are to prosper. But it could require some time for that logic to overcome the bitter legacy of seventy years of Soviet socialism.

For now, there is not a great deal the West can do except to stand ready with whatever technical expertise might be useful in devising a strategy. Should some version of the Shatalin Plan—more carefully prepared and more thoroughly documented—eventually be adopted as policy, then loans and even aid would be in order to support the process, providing a much-needed boost at the beginning by expanding the supply of consumer goods, thereby reducing the tendency toward hyperinflation. But financial aid of any magnitude will only be justified when, and if, a consensus emerges within the U.S.S.R. around a plan that makes sense. Until that occurs, no amount of Western goodwill or aid will set things right.