WHY PERESTROIKA FAILED

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INTRODUCTION

Ideas, unless outward circumstances conspire with them, have in general no very rapid or immediate efficacy in human affairs; and the most favourable outward circumstances may pass by, or remain inoperative, for want of ideas suitable to the conjuncture. But when the right circumstances and the right ideas meet, the effect is seldom slow in manifesting itself.

John Stuart Mill

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The most dramatic event in political economy to happen since the Great Depression of the 1930s was the collapse of the Soviet system and its satellites in the late 1980s. The Soviet admissions of the failure of their economic system to provide a decent standard of living to its people, let alone keep pace with the technological advances of the West, caught most Western Sovietologists by surprise. Watching the developments (zigs and zags) of perestroika and glasnost became a full-time occupation for many economists.

The events in the Soviet Union since 1985 have been nothing short of spellbinding. Academics, pundits and the man on the street have been transfixed by the 'Gorbachev phenomenon.' The turning point of the Soviet reform effort, however, came in 1989. One former satellite after another during that fateful year withdrew from the Soviet empire with Gorbachev's blessing. Poland, Czechoslovakia and East Germany dramatically went their own way. The Berlin Wall fell, both figuratively and literally. The Brezhnev doctrine was repudiated by Gorbachev.

On the economic front, the pace of the Gorbachev reforms seemed to quicken (at least in rhetoric) as 1990 approached. No longer did the
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reform rhetoric limit itself to tactics for improved efficiency of economic administration. Now fundamental systemic issues were debated. Private property, free market pricing, currency convertibility, etc., were legitimate topics of discussion among the Soviet Union’s leading economists. These economic discussions culminated in the debate in the late summer and early fall of 1990 over the Shatalin 500-Day Plan. The plan was at one and the same time a draft of a constitution for a new confederation of free sovereign republics, an outline for a market-based economic system for the new confederation and a plan of transition from the old union to the new confederation.

But as is usually the case in political discussions, rhetoric diverged significantly from reality. Gorbachev quickly abandoned the Shatalin Plan and its political and economic program. A compromise Presidential Plan emerged in October 1990, which while maintaining some of the rhetoric of the Shatalin Plan, eliminated all of the details. Both the political and economic reforms in the Soviet Union possessed troublesome paradoxes that simply exacerbated the crisis situation. In the lead up to the failed August 1991 coup, the situation in the Baltic states highlighted the political troubles with the Soviet reforms just as the long lines and empty shelves highlighted the economic woes that continued to plague the Soviet people. Perestroika as an economic reform program failed to bring lasting and systematic change to the moribund Soviet economy.

This book represents a critical assessment of the reform effort (1985–91). The common theme that runs throughout the book is that only on the basis of a sound understanding of the operation of market and political processes can one begin to analyze the Soviet-type system, and the efforts to reform it, with any degree of accuracy. From this theoretical basis, best developed by scholars working within the Austrian (market processes) and Public Choice (political processes) schools of economic analysis, the various proposals and paradoxes of the Soviet effort are examined.

Perestroika failed in large part because it was not tried. Gorbachev between 1985 and 1991 announced at least ten radical plans for economic restructuring, not a single one was ever implemented. But even if perestroika – as represented in the major proposals and decrees – had been implemented it would not have produced the structural changes necessary to revive the Soviet economy.

Though the events examined are limited in large part to the reform history from 1985 to 1991 – a working knowledge of which would be

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necessary to examine any direction the former Soviet Union may take in the foreseeable future – emphasis will be on the theoretical problems that economic reform confronts in general. Knowledge of the reasons why perestroika failed may provide us with important general lessons for how to proceed in charting a new course in the former Soviet republics and Eastern Europe.

OVERVIEW OF THE BASIC PROPOSITIONS

There are two general questions which the various chapters in this book attempt to answer. First, if socialism as an economic system was so inefficient, how could it have lasted for seventy-four years? Second, if market reforms are so desirable, why have all the transforming economies experienced an acute economic decline during the reform period? Both of these questions will be answered through a series of propositions which taken as a whole provide the critical answers. Each of the chapters will try to address a specific proposition and tease out its implications.

Proposition 1: Soviet economic strength was an illusion

It has become commonplace among neo-conservative commentators in the West, and even some Soviet intellectuals, to argue that the breakdown of the Soviet empire in the late 1980s was due to Ronald Reagan’s military build-up in the early part of that decade. By raising the stakes in the international military game, Reagan put the final strain on the Soviet system. However accurate this perspective is concerning the weight of the military burden on the Soviet economy, it does not address the systemic issues and problems surrounding the Soviet economy. The real question that must be raised is whether the Soviet system could have continued even if no military pressure was exerted by the West.

The neo-conservative perspective on the Soviet problem is untenable because it underestimates the extent to which military power is derived from a prosperous economic base and it overestimates Soviet economic strength. Questioning the neo-conservative hypothesis, however, should not be construed as support for the alternative suggestion that Mikhail Gorbachev was responsible for the break-up.

Gorbachev did not become General Secretary to reign over the demise of the Soviet empire. Any view that draws our attention away from
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The structural problems the Soviet system faced throughout its history will fail to grasp the meaning of the Soviet experience with socialism.

Even if the US and the West had reduced the military stakes in the 1980s, the Soviet economy was doomed to fail. The Soviet system was structurally weak since its founding and collapse was inevitable. The economic fact that, as Aleksandr Zaychenko stated, 'Russians today [in 1989] eat worse than did Russians in 1913 under the Czars' had little to do with the military strains of the Cold War and everything to do with the structural problems of socialist economic institutions.

The illusion of Soviet economic growth and progress was due to the failings of aggregate economics, in general, and an odd combination of ideas and interests in academic discussions which did not allow dissenting voices to be heard, in particular. In fact, the whole peculiar art of Soviet economic management amounted to the production, and distribution of this illusion.

To illustrate the conflict between Western perceptions of socialist industrial achievement and the realities of the formerly socialist economies, one need only consider the fact that prior to German unification, East Germany was considered the flagship of the socialist industrialized world. Now it is evident to all that the East German economy was a shambles—incapable of producing anything close to world standards for an industrially oriented nation. We now know just how inefficient these economies actually were.

It is not at all an exaggeration to say that in economic terms the socialist economies of Europe were Third World economies. As George Orwell pointed out in Animal Farm, to the outside world the farm may have appeared as if it was productive and prosperous after the revolution, but inside the farm the animals worked harder and ate less than they ever did before.

Proposition 2: Socialism as originally conceived was (is) an economic impossibility

Soviet-style socialism did not fail because of half-hearted attempts or because of backward political and economic conditions, rather socialism as originally conceived of by Marx, Engels, Lenin and Trotsky was simply a utopian dream incapable of realization in any world populated by human beings. This not mean that an attempt to realize utopia cannot take place, just that utopia can never be achieved.

In assessing utopias, it is important to clarify two issues. First, the...
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allocated according to political rationales rather than economic ones.
with the corresponding waste that would be expected. But waste was	not penalized in the Soviet system of bureaucratic management. As
long as output targets were met, and everyone in the process received
the perquisites due to them, then the Soviet manager was judged a
success. Certainly such considerations as consumer demand were not
to enter the state enterprise manager's calculations.

Economic reform demanded a change in this way of doing things,
but change was sure to be resisted. The bureaucratic caste could not be
expected to give up voluntarily its privileged position in society.

Proposition 4: The basic organizational logic of politics conflicts
with the logic of economic reform

Perhaps one of the oldest debates in the history of political economy
is over whether ideas or interests govern policy change. Karl Marx,
for example, argued that the economic base determined the super-
structure. In other words, ideas flow from economic interests. John
Maynard Keynes, on the other hand, argued that the impact of
interests was largely overestimated, rather it was ideas that govern
the world. conceptually, they both may be right.

The complex interaction of ideas and interests produces an
intellectual climate within which the policy exists. Ideas, for example,
which demand more government involvement, also create an interest
group which will benefit from the intervention. Thus, ideas and
interests work together to eliminate the constraints to government
involvement in the economy that may exist. The logic behind this is
rather straightforward.

It must be recognized that government, whatever form it takes, is
an institution that can be, and will be, used by some to exploit others
unless effectively constrained. Under democracy, politicians (by
definition) seek election or re-election, and in order to accomplish
that goal they require votes and campaign contributions. On the other
hand, most voters confront a situation where the incentive to gather
political information is absent. The expected value of any one vote is
usually much less than the cost associated with even the simple act of
voting let alone casting an informed vote. The expected value of
political information on any candidate or issue is far less than the cost
associated with seeking that information unless the voter has a
selective incentive to acquire particular information. Rational absten-
tion from voting and rational ignorance among voters is a natural
outcome of the logic of individual choice within the democratic
political process. Well-informed and well-organized political groups
are so because the members have a selective incentive to be informed
and organized, i.e., they have a special interest in the issue under
discussion. These special interest groups will supply both the votes
and campaign contributions that politicians need to be successful in
their bid for office. The main objective of political action, therefore, is
to concentrate benefits on the well-informed and well-organized
interests which represent a politician's constituents and disperse costs
among the unorganized and ill-informed mass of citizens. The bias in
government policy-making is, therefore, one that yields short-term
and easily identifiable benefits at the expense of the long-term and
largely hidden costs. Despite the soundness of an economic policy,
unless it can pass that bias test it is most likely destined for the
political scrap heap.

Political programs for reducing government involvement in the
economy for any particular action, for example, entail great costs and
offer very little relative benefit in return. A reduction in government
involvement in the economy results in short-term and easily identifi-
cable costs to the existing bureaucracy with the promise of long-term
and largely hidden benefits to consumers. Stated bluntly, if the logic of
politics is to concentrate benefits and disperse costs, then the logic of
political and economic liberalization is to concentrate costs on the
existing interests who benefit from current government action and
disperse benefits in terms of enhanced consumer welfare, and as such,
the two logics conflict with one another.

Perhaps a simple example from a democratic regime may illustrate
the point. Say a proposition is put forth that teachers will perform
better if they receive a $1,000 increase in pay. The cost of the
government's education program, however, will be dispersed among
taxpayers of the state as an increase in their state income tax of $1. In
order to be well-informed on the issue and work to defeat the passage
of the government's proposed program it would cost the individual
opponent of the bill in excess of $100 in terms of time and expense.
Such an activity is not economical for most individuals and, therefore,
they will remain rationally ignorant of the issue. On the other hand,
teachers who expect to receive $1,000 will take the time and
additional expense to make sure that the program passes. The
interaction of politics under democracy pits vote-seeking politicians
and special interest voters on one side against rationally ignorant
voters on the other. This interaction produces certain biases in the

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system which tend to support the ever increasing expansion of government involvement in the economy.

If we reverse the situation so that teachers face a possible cut of $1,000 in their pay and tax payers pay $1 less in state income taxes, then the logic of politics produces strong resistance to reform. The teacher again who expects to lose $1,000 in pay will work very hard to resist the passage of a program that calls for such austerity. On the other hand, tax payers could only expect to receive $1 and as such will again remain rationally ignorant.

To return to the theme of ideas and interests, it does seem that ideas matter in the direction of greater government involvement because they may erode the constraints that existed concerning government action. In other words, ideas can be enlisted in the service of well-informed and well-organized interests when those ideas suggest more government intervention. However, ideas and action in the direction of less government involvement in the economy cannot enlist the service of powerful interests - in fact, the opposite is true since reduction in the size of government requires the defeat of interests.

The basic logic of politics derived from the analysis of democracies is intensified under non-democratic regimes such as the Communist regime of the former Soviet Union. Here, even the façade of public interest quickly disappears. The role point of the system was to concentrate benefit on those in power and disperse the costs on the citizens. The beneficiaries of such a structure were simply not going to give up their privileged positions easily - it would be irrational for them to do so. In fact, endogenous reform would violate the maximum of rational choice because it would require that members of the dominant interest group move in a Pareto inferior manner.

Only an exogenous shock, such as war, natural disaster, economic depression or an ideological revolution, could displace the intransigent interest group. At such moments, ideas can play a dominant role by restructing the basic relationship between the citizen and state. But, without such moments the logic of politics will defeat efforts in economic liberalization.

Proposition 5: Without a credible commitment to economic liberalization, reform efforts are doomed to fail

Even if an exogenous shock displaces the dominant interest group and the opportunity for real economic liberalization presents itself,
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Proposition 6: Only a radical reform that changes the basic relationship between the citizen and the state can get a moribund economy back on track to progress and development.

The steps necessary to rejuvenate the Soviet economy are rather straightforward and radical. The government cannot simply copy the Western welfare states because they do not have the economic base which is necessary to establish such a system. The mal-investment that resulted from years of state economic management must be corrected. Unfortunately, most individuals in these economies wake up every day and go to work at the wrong job, in a factory that is in the wrong place, to produce the wrong goods. Many of the firms actually contribute ‘negative value added’, that is, the value of the inputs in the production process is greater than the market value of the output that is produced. This is the legacy of decades of attempted central administration of the economy.

There is no medicine for this except a strong dose of market discipline. But strong markets will only emerge if a rule of law establishes private property and freedom of entry. All other ideal policies follow from these two principles. The private property order, unlike the communist property order, offers an internally consistent vision of a workable utopia.

CONCLUSION

Each of these propositions will be dealt with at much greater length in the chapters that follow. I can, however, offer a brief answer to the original questions posed that derives from weaving these propositions together.

Real existing socialism did not represent Marxian socialism because Marxian socialism was (is) an internally inconsistent utopia. Rather, mature Soviet-style socialism was the unintended by-product of attempting to implement the Marxian dream and the institutional legacy of that attempt. Soviet-style socialism was able to muddle through slowly eroding the accumulated surplus fund it inherited from natural resources, internal imperialism (e.g., collectivization in the 1930s), and external colonialization (Eastern Europe after the Second World War), in large part because of the illicit markets that existed throughout the system and through the use of world prices in allocating scarce natural resources. Thus, Soviet-style socialism was able to last over sixty years because it took that long to exhaust the accumulated surpluses and reach a point of acute economic crisis (I am dating the secular stagnation to the 1970s).

In terms of why market reforms have actually recorded a worse crisis than we had previously believed possible, a few issues need to be addressed. First, because of the previous overestimation of economic capability the costs of the transition are often overstated. In an excess demand economy, like the former Soviet bloc countries, allowing prices to adjust to market clearing levels may appear, according to wage deflated by price index measurements, to decrease the standard of living. In actuality, however, what has happened is the elimination of the queue. Similarly, if previous production measurements concentrated on output targets independent of consumer demand, then the introduction of markets would suggest a reduction in production, when the production of unwanted and poor quality products had simply ceased. The introduction of market forces, when compared to the bogus measurements of the previous socialist regime, would bring with them the appearance of severe reductions in standards of living as a consequence of measurement problems. Eliminating queues and curtailing the production of sub-par and useless products should not be viewed as threats to consumer welfare. Real reforms represent a radical break with the previous system.

In the actual experience of reforming the formerly socialist economies, however, the problem is more severe than just mismeasurement. In the case of the former Soviet Union, reform simply did not take place. As a consequence, while the old regime and old way of doing things had been de-legitimized, no new system had been able to emerge to promote social cooperation under a division of labor. Illicit markets and small-scale markets continued to operate, but large unregulated markets are still a thing of the future. However, without the introduction of large-scale markets and the establishment of a rule of law that protects unfettered markets, the peoples of the former Soviet Union are doomed to continued economic deprivation.
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The processes of market interaction fundamentally lay beyond our control. Rather than attempt to design optimal plans and control social forces, our intellectual efforts must be devoted to asking questions about the institutional framework within which activities beyond our control will take place. Raising and providing useful answers to such questions, however, requires an array of disciplines.

Economics is an important, in fact essential, component in this inquiry. But, economics cannot provide all the answers. Politics, philosophy, history and cultural theory, along with other intellectual disciplines and common sense, must also be employed.

Most importantly, though, moral reasoning must be allowed to regain a legitimate place in scholarly endeavors. Perhaps the most fundamental reason why Sovietologists were so surprised by the events of the late 1980s was the hegemony of a scientific methodology which disregarded evidence from the humanities (such as literature and personal testimony) and dismissed questions of human meaning as metaphysical nonsense. Reasoned debate about such fundamental issues can, and must, take place if we are to think in an effective way about the politics and history of our times.

NOTES


3. See Ed Hewett, The new Soviet plan,’ Foreign Affairs (Winter 1990/91): 146–67. Hewett argues that the major strength and stumbling block to the 500-day Plan was the issue of confederation which correctly recognized the collapse of the union, but was a position which Gorbachev simply could not endorse in the fall of 1990. The Ryzhkov Plan, on the other hand, while retaining central power, granted some increased autonomy to the republics. Gorbachev enlisted the services of Alexei Iagubyan to draft a compromise plan of the Shatalin and Ryzhkov Plans, which eventually became the Presidential Plan.


5. Boris Pinkser, a leading pro-market Soviet intellectual and the husband of Larissa Popkova-Piyasheva, holds the opinion that Reagan’s military build-up was the major contributory factor responsible for the breakdown of the Soviet empire. (Personal conversation with Pinkser on his visit to New York in 1991.) A sample of Pinkser and Piyasheva’s views can be found in Lev Timofeyev (ed.) The Anti-Communist Manifesto.
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6. The idea of Gorbachev as a benevolent liberal reformer became the dominant Western perspective after the events of 1989. See, for example, the discussion of Gorbachev in Joshua Murawchik, 'Gorbatchev's intellectual odyssey', New Republic (5 March 1989): 20-5. Murawchik argued that Gorbachev may just complete his odyssey by sailing the Soviet ship of state safety beyond the grotesque churches of Liberalism and Marxism to the friendly port of democracy and freedom. For the events of 1989, Gorbachev was awarded Man of the Decade by Time and won the Nobel Peace Prize.


9. Aggregate measurements of well-being, such as per capita GNP, place the former Soviet Union at about 25 per cent of the corresponding figure in the US economy. See PlanEcon Report, 5 (52) (28 December 1990): 17. However, since many goods are not available in the state stores at the official price, many families live below the official poverty line in a shortage economy.

10. See George Orwell, Animal Farm (New York: Harcourt Brace Jovanovich, 1946). Orwell's book was a parable of the corruption of the Soviet revolution by Stalin and the consequences of collectivization and industrialization. The ideological dictum that all animals are equal gave way to the reality that though all animals were equal some animals were more equal than others. In the end, one could not tell the difference between the pigs (the leaders of the animals) and the humans outside of the farm -- the pigs had become just like their previous oppressors.


12. See the pioneering studies on non-market decision-making under non-democratic regimes by Gordon Tullock, The Social Dilemma ( Blacksburg, VA: Center for Study of Public Choice, 1974) and Autocracy (Boston: Klawer, 1987).


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7. Pravda (9 November 1991): 1, translated in The Current Digest of the Soviet Press, 43 (43) (11 December 1991): 1-2. Though no official government parade occurred, two demonstrations did take place. At one demonstration, in fact, several pro-communists set flowers at the feet of the Lenin monument and carried signs denouncing Gorbatchev and Yeltsin. In the other demonstration at Lubynka (formerly Dzerzhinsky Square), pro-democracy groups held signs that included one that read: "Lenin - the national disgrace of Russia! Forgive us, Russia, for this