No. 259 3 Av 5752 / 2 August 1992

THE CIS ECONOMY IN TRANSITION

Alexander Granberg

The USSR Economy Before Perestroika / Disintegration of the Union Quasi-Market / Causes of Disintegration / Phenomena of Disintegration / The Question of Pricing / "Barterization" of Trade / Rationed Trade and Money Surrogates / Converting to a Market Economy

The USSR Economy Before Perestroika

The economic system which had existed in the USSR before the launching of perestroika (1985) was based on domination of state property and administrative command by the state government. Market relations played a subordinate role.

There existed two restricted commodity markets in the country — the consumer market and the market for industrial goods (means of production). Both types of markets, despite an apparent similarity of agents and attributes (producers, sellers, buyers, banks, money, prices, credit, etc.), displayed qualitative differences both from the "classical" market and especially from the contemporary Western model of commodity markets. The principal differences were: 1) domination of the public (state) sector in all sectors of the national economy; 2) monopolization of production, particularly in industry, and lack of serious competition among sellers; 3) rigid separation of external and domestic markets (by means of state foreign trade monopoly, customs and price policies); 4) fixed prices (subject to change normally only once in five years) of most goods produced and distributed; 5) consistent excess of demand over supply (shortage) in most items and in the mass of commodities as a whole; 6) substantial state subsidies to producers, especially for foodstuffs (over 100 billion rubles annually). The essence of incipient liberalization and spontaneous erosion of the Soviet economy consists in relaxation of these properties.

In the 1980s there began a slow process of liberalization. Certain industries were allowed to dispose of part of their output at their discretion and the scope of the state plan was reduced; alongside fixed state prices there appeared contract prices (in deals between enterprises). However, those changes were unsystematic and insufficient for establishment of a parallel free market for means of production. A new law on state enterprises that was passed in 1988 also fell short of the revolutionary expectations.

For all its apparently strange and even paradoxical features, until the early 1980s the Soviet quasi-

Daniel J. Elazar, Editor and Publisher; Zvi R. Marom, Associate Editor; Mark Ami-El, Managing Editor. 13 Tel-Hai St., Jerusalem, 92107, Israel; Tel. 02-639281, Fax 972-2-639286.
ISSN: 0334-4096.

The Jerusalem Letter is a periodic report intended to objectively clarify and analyze issues of Jewish and Israeli public policy.

market represented a consistent system which was inertially reliable and provided continuous, if decelerating, economic growth. It is precisely the systemic nature of the quasi-market that accounts for numerous failures of attempts at its "perfection," that is, improvement of its individual elements.

Disintegration of the Union Quasi-Market

A crisis in union and regional commodity markets began to be felt in 1988. The volumes of interregional exchange decreased in many output items; the overall volume of interregional trade over the year increased, but to a lesser extent than total production output. In 1989 erosion of the interrepublican market intensified, the total volume of interrepublican exports contracted in absolute terms in three union republics, and the volume of imports decreased in five republics. By 1990 the disintegration had sharply accelerated. The total interrepublican commodity exchange decreased by 2.2 percent.

In 1990, for the first time in decades, the USSR saw a general production decline, one that accelerated in 1991. In the first half of 1991 as against the first half of 1990, the gross national product of the USSR fell by 10 percent and the output of most industries declined. Naturally, this led to a contraction of the potential physical capacity of the union market.

Despite the ongoing liberalization of foreign trade (stimulation of exports, sanctioning direct entry in the foreign market rather than through central structures, creation of joint ventures, partial domestic convertibility of currency), foreign trade turnover in 1990 decreased by 6.5 percent and, in the first half of 1991 as against the same period the previous year, by 37 percent (exports by 23 percent, imports by 48 percent). Besides the disintegration of COMECON (trade with former COMECON members decreased drastically over the year) and deterioration of trade conditions, the causes of the decline included diminishing export potential (especially in oil), mounting foreign debt, and an inability of Soviet commercial partners to pay for supplies.

An unprecedented rise in state prices early in 1991 failed to produce equilibrium as black market prices were much higher than state prices (for food, clothes and footwear — 3-5 times, cars — more than 4 times, medicines — 14 times). Reserves of most goods in the trade network and industry shrank to a minimum.

Causes of Disintegration

The aggravation of chronic ailments of the quasi-market and its progressive disintegration in 1988-1991 were caused by a combination of processes:

There was a crisis of money circulation, with a constant surplus of money in circulation, systematic excess of demand over supply, price increases, depreciation of savings, and a catastrophic drop in the ruble exchange rate in the domestic currency market (falling to 40-60 times less than the official rate), as the fiscal measures of the union government definitively undermined confidence in the ruble both in the public and private sectors. This resulted in uncontrollable demand sweeping off the shelves of shops all goods sold at state prices and conversion to barter exchange.

The transition from the administrative command economy to a market economy was proceeding slowly, with long pauses, unsynchronously and selectively. Thus, abolition or reduction of state production assignments and liberalization of state prices were carried out unevenly by industries and types of output. Some enterprises were allowed to choose new trade partners and produce goods at their discretion, while others continued to operate within a strict framework of state plans and prices. As a result, old economic ties partially disintegrated, while the establishment of new mutually beneficial relations was delayed.

Since 1988 there has been an active movement for economic and political independence in the union and autonomous republics. The Baltic republics were followed by the Russian Federation; then the movement spread to the intrarepublican level. Simultaneously, restructuring of the political system of the USSR proceeded: liquidation of the Communist party's monopoly, formation of new elected authorities, democratization of social life. Administrative functions were redistributed from the center to the republics and local authorities. This many-sided progressive political process developed with difficulty, creating additional tensions in the economy and contributing to disintegration of the union economic space.

In order to protect their markets from the pressure of external demand and to improve trading conditions, republican and regional authorities banned interregional export of goods, began to collect customs duties, and attempted to introduce money substitutes. They issued their own laws contradicting the decisions of higher levels of authority (the "war of laws"). Additional factors in economic destabilization were massive miners' strikes and inter-ethnic conflicts.

Phenomena of Disintegration

The "sovereignization" of the union republics, their political and institutional dissociation from the union center, gave a major impetus to the disintegration of the economic space of the USSR. Beginning in 1988 the most pronounced forms of confrontation with the center were typical of the Baltic republics, and after mid-1990 of the Russian Federation (following Yeltsin's victory in presidential elections in Russia and adoption of the Declaration of State Sovereignty of the Russian Federation).

In an effort to protect regional markets in a situation of pervasive shortages and expansion of "hot money," republican and local authorities prohibited the export of goods produced in the republic or available in retail trade outlets. Such actions which were motivated by populist considerations met with support of the local population. After August 1991 the Ukrainian government forbade the export of sixty types of consumer goods and imposed severe restrictions on carrying food across the republican border.

In certain republics attempts were made to control the (interrepublican) export of any goods by the introducing of licenses and quotas. This created an intermediate administrative link between enterprises of different republics maintaining direct ties. Such practices did not exist before perestroika.

Some republics also imposed special duties. For example, in Uzbekistan, duties on exports of agricultural produce to other republics in July-September 1991 amounted to 20 percent of their average annual price, and in October-December — 80 percent. In other republics, such as Moldova, customs duties have been instituted on export of goods above certain quotas. With a view to exercising control over the movement of goods and population, republics began to organize their own customs services (Estonia, Latvia, Lithuania, Byelorussia, Ukraine, etc.). Laws on republican economic frontiers were passed, partners in economic relations naturally reciprocated, and "customs wars" flared.

A new form of exercising regional economic "sovereignty" is the priority right of local authorities to purchase part of the goods produced on their territories (as a rule, between 5 and 15 percent, though territories of the Far East have claimed the right to 30 percent of local goods). The goods thus procured are used for intraregional consumption as well as for barter exchange with other regions. The population, enterprises and local authorities seem to develop a common interest: growth of local production for better satisfaction of local needs. But a situation of stagnation and decrease in production further reduces opportunities for free interregional trade.

The Question of Pricing

Pricing in the USSR had always been divorced from the market, being nearly entirely the monopoly of the state. It did not have any serious effect on the pattern and dynamics of production or the flow of capital. The destructive effect of price deformations began to show with the liberalization of activities of state enterprises, growth of the cooperative and private sectors, and expansion of republican and regional independence which affected the conduct of economic policies.

One new phenomenon in pricing which promoted disintegration of the union market space was the lack of coordination in price policy between the union and the republics, and the resultant gaps between republican price levels. Previously, when most prices were set by the union government, the interrepublican (regional) differences were insignificant and had little effect on the flow of goods. The situation changed beginning in autumn 1990, when republics began unilaterally to raise food prices. First Russia raised the price of cattle, and then Estonia, Latvia and Lithuania on their own raised food prices (more than 3 times on average), simultaneously raising wages in state organizations (2-2.5 times), removing wage constraints in commercial enterprises, and providing for compensation payments to the population. The purchasing power of the ruble in those republics drastically dropped against the other republics, where additional demand shifted (especially for foodstuffs in cross-border areas). This prompted protective measures: bans on exports of food, expansion of food rationing, followed by general price increases in all republics and the onset of a new cycle.

Discrepancies between state and market prices of means of production also began to appear. Enormous differences in prices of consumer goods sold through the state and cooperative retail trade networks, in the "collective-farm," and black markets are a traditional phenomenon of the Soviet economy. However, the state has always maintained unified fixed prices for means of production (capital goods). In conditions of shortage and with monopolies of producers, liberalization of prices of some goods inevitably led to their abrupt increase. Such behavior resulted in financial damage to consumers as well as a disincentive for producers even to maintain the level of output, let alone increase it.

Uneven price liberalization by industries had the effect that the output of some regions was sold mainly at free prices, while that of other regions (primarily raw-material producing) continued to be sold at fixed state prices. As a consequence, the former financial and social disparities between "manufacturing" and "extracting" regions were considerably increased. The latter sought conversion to free prices, but the government's cautious attitude was due to concern that instant freeing of prices of fuel and raw materials might result in bankruptcy for thousands of enterprises and reduce trade turnover and levels of production.

Oil provides the most striking example. The state price of Tyumen oil was 60 rubles per ton, while at the commodity exchange in mid-1991 it went for 350-400 rubles, that is, 6-7 times as much, and when exported abroad (including by producers themselves) it brought $150 per ton. By selling the dollars at an auction the producer could receive 4,500-5,200 rubles for a ton of oil, which is equivalent to the sale of 75-87 tons at state prices. Clearly, with the colossal differences between state and market prices and the domestic exchange rate of the dollar, producers have little concern for the process of oil extraction; as businessmen, they are much more interested in winning the right to sell their output at free prices.

Gaps in price levels at local markets also began to appear as a result of trade barriers. As is known, one of the attributes of a unified market space is equalization of prices in local markets with the exception of transportation costs. However, this is not the case wherever there are obstacles to free trade.

Overall, prices are highest in Moscow, followed by Leningrad. These peaks of prices are probably due to two reasons: 1) the fact that in those cities collective-farm markets are patronized by a relatively small group of the most prosperous customers, while the greater part of the population rely on state trade with its lower prices; 2) obstacles to free supply of collective-farm markets in Moscow and Leningrad put up partly by organized crime groups. In the past, when the two cities were at the top of the priority list in state food supply, the first reason was predominant. According to Moscow experts, in recent years the two factors have changed places in hierarchy of importance.

"Barterization" of Trade

The widespread barter practice is an inevitable consequence of decomposition of the old system of material and technical supply and loss of real-money properties by the ruble. Initially, barter transactions were carried out by enterprises; later they were joined by municipalities and authorities at different levels. In various local markets the function of money is discharged by certain scarce goods: meat, cigarettes, cars, etc. For example, at the agro-industrial fair in Omsk in March 1991, money was meat, which served as a measure for other goods: 1 ton of meat is equal to 10 color TV sets, etc. Attempts have been made to forbid barter to the detriment of state orders and contracts, but official bans have been systematically breached. Needless to say, moral censure of barter as a return to the Middle Ages did not help. Finally, the government realized the futility of its battle against an effect without tackling the cause and barter has been permitted. Moreover, the government itself began to resort to barter in autumn 1991 to purchase grain. One Kamaz truck will be exchanged for 400-500 tons of grain, one Lada car for 250-300 tons, a refrigerator — 8-10 tons, a sewing machine — 5-10 tons.

Rationed Trade and Money Surrogates

The transition from free trade to limited and rationed distribution of consumer goods is tantamount to a return to the war and post-war period. The qualitative distinction consists, firstly, in the variety of distribution forms used, and secondly, in the regulation of the distributive mechanism exclusively by republican and municipal authorities. Spatial heterogeneity and fragmentation of the consumer market has been further increased by such regional initiatives. The variety of limited, rationed trade follows four basic forms:

1. Sale of goods only to local citizens (of a town or district) possessing a document confirming identity (passport, buyer's card, etc.); this form of consumer market localization has proved inadequate and is hardly used today.

2. Sale of scarce consumer goods to employees of enterprises (with either the shops delivering their goods for sale directly at the enterprises or serving employees of a particular enterprise at the shop on a specified day).

3. Sale of a certain nomenclature of goods within fixed norms against impersonal certificates (cards, coupons, etc.). The lists of rationed goods most often included sugar, vegetable oil, cigarettes, and alcohol. The drastic increase of state retail prices in April 1991 did not achieve an equilibrium in the consumer market, but reduced large low-income segments of the population to a critical situation. Nevertheless, the list of rationed goods has shortened; in most cities it now

excludes meat and butter. In practice, cards and coupons did not ensure availability of goods; often supplies of goods in shops fell short even of minimum norms. In addition, coupons or cards were often falsified or sold by their owners to other persons.

4. Issuing of money surrogates as a priority means of payment. Experiments in this direction were carried out on the largest scale in the Ukraine. Since autumn 1990, 70 percent of the amount of wages, pensions and allowances have been paid in coupons of different denomination (3, 5 rubles, etc.) backed by a guaranteed commodity supply (they have been dubbed "the money of perestroika").

The introduction of coupons enhanced reliability of supply and abated excessive demand within the republic, but simultaneously depreciated that part of money (including all savings of the pre-coupon period) which is not provided with coupons, since it can only be used in the republic to buy goods at high (market) prices. For the union commodity market and financial system, the couponization of the Ukraine was an appreciable shock. First, the Ukrainian government secured the right to prohibit exports of consumer goods required for provision of coupons. Second, "hot" money not covered with coupons was being actively siphoned into adjoining republics with a relatively free regime of trade, where it has higher purchasing power. In July 1991 coupons were abolished, only to be restored a month later.

In effect, coupons represent parallel money which can diverge from the ruble and turn into the republican monetary unit. As in many other new situations of the Soviet quasi-market, the black market has become the barometer. The ruble exchange rate for coupons is already more than double the face value. Criminal groups have also responded by forgery, which is easier to do than with official bills.

In the summer of 1991 parallel money (general coupons) was adopted by Lithuania. In combination with rubles they became a means of buying a wide range of goods in special shops. All former city and district coupons have been repealed. In Lithuania, Latvia, and Estonia the circulation of parallel money is viewed as a step towards the introduction of their own monetary units instead of the ruble (lits, lats and kronas, respectively).

Converting to a Market Economy

The contemporary transformations of the Soviet economy are of a contradictory character. Concurrently with the visible deterioration of the economic situation and the ongoing disintegration of the market, there are developing qualitatively new forces for the creation of real market elements.

The last two years have seen the accelerated formation of different forms of property that are new to the USSR: state, municipal, private property and the property of social organizations. In the Russian Federation alone, some 65,000 partnerships of various types had been created by early 1992 including 9,000 joint-stock companies, 3,100 economic associations, 1,300 commercial banks and over 110 commodity and stock exchanges. There were more than 10,000 cooperatives and 50,000 private farms with a total land area of 2.1 million hectares. In 1991, non-state enterprises accounted for 13 percent of industrial output and 23 percent of construction. Leased retail stores provided over a third of total turnover.

The failure of the August 1991 coup had devastating consequences for the whole of the Soviet system with two aspects of particularly economic importance: 1) the loss of authority and real power by the union center (including the President of the USSR); 2) the choice by Russia, followed by the other republics, of accelerated and irreversible conversion to a market economy.

The period after August saw a resumed negotiation process between the center and the union republics culminating in December when Russia, Ukraine and Byelorussia established the Commonwealth of Independent States (CIS), which was soon joined on equal terms by 8 other republics. The Soviet Union ceased to exist, yet all its problems remained. The first accords reached by the republics on trade and payments, preservation of a common currency system, unification of economic legislation, responsibility for repaying the foreign debt of the USSR, and others do not yet provide sufficient guarantees of economic reintegration. However, the economic space now in the making will undoubtedly be market-oriented.

* * *

Professor Alexander Granberg is a senior official in the Yeltsin administration dealing with problems of interregional relationships and the economy. He was chairman of the Committee on Interrepublic Relations of the Russian Parliament, and was former Director of the Institute of Economics and Industrial Organization in Novosibirsk, Russia. The Institute is on its way to becoming the first institute for federal studies in the former USSR and has joined the International Association of Centers for Federal Studies.