

The role of institutional change in the collapse of the Soviet/ Russian economy 1985 – 1996

INTRODUCTION

All the post- Soviet economies¹ suffered severe recessions in the 1990's. Arguably, this collective collapse is the greatest peacetime economic catastrophe known to economic history. Yet, while it is often referred to, it has not been the subject of systematic study. Economists, both neoclassical and heterodox, seem to be confident that they understand what happened well enough: the chaos was mainly the result of the inherent weakness of the 'Command economy' (as Soviet planning system it is often called).

This paper analyses the economic catastrophe and shows that its scale is such that the logic of the standard view must be called into question. It demonstrates that:

- Firstly, the catastrophe is a post-Soviet phenomenon. Whatever problems the old Soviet system may have had they were nothing like those experienced after the end of the system.
- Secondly, there was no 'final economic crisis' of the planning system. Far from living on after the collapse of the political system of Communist Party rule, the Soviet economic system was dismantled and the transition to the market was underway *prior* to political collapse.
- Thirdly, all the features of the post-Soviet economy can be explained in terms of the operations of the market economy: there is no need to invent any special stage.

THE GREATEST PEACETIME ECONOMIC CATASTROPHE KNOWN TO ECONOMIC HISTORY

"..all but the most outlandishly panglossian takes on the Former Soviet Union see it as an unmitigated disaster." (King 2000)

Following the political collapse of the Soviet system, in Eastern Europe and the Soviet Union itself, the economies of all these countries underwent a radical reorganisation. At the same time they also went into crisis. This took many forms: falls in production and consumption, rapid inflation, and the re-emergence of unemployment. These problems were protracted, lasting for most of the decade in some cases. The severity of these symptoms varied from place to place but even in the least affected countries, such as Poland, they were extreme by post-war Western European standards.

In short, economies in a number of countries became dysfunctional on a catastrophic scale. This situation is analogous to the Great Depression of the 1930's. I will argue that in its total destructiveness and duration what happened to the former Soviet Unions and its erstwhile allies was worse than the Great Depression. We should now acknowledge that the old benchmark has been surpassed. I propose that we call this event the Great post-Soviet Depression (GPSD)².

The benchmark of the Great Depression of the 1930's

Following the First World War the US became the world's largest economy and single most important economy. After booming for a few years, the US economy began to slow down in 1929. Unemployment grew to an unprecedented 25 percent of the labour force, real wages were cut, personal consumption and investment fell. GNP declined continuously for 4 years, it finally bottomed out 28.9 percent below the 1929 level. In 1936, seven years after start of the recession, real GNP was at 97 percent of its pre-depression peak. It was only in 1939 that the economy exceeded the 1929 zenith. The entire world economy was caught up in the crisis, though not all countries were affected as badly as the United States. This was the Great Depression of the 1930's. Up until recently this depression has generally been taken to be the most serious peacetime economic downturn in economic history.

¹ In referring to states and economies in Eastern Europe and the former Soviet Union I will use the term post-Soviet. I choose this term as more neutral than post-socialist or post-communist.

² [Michael S. Bernstam](#) and [Alvin Rabushka](#), use the term 'the Great Contraction'

The Soviet system

In the years after the end of the Second World War the Soviet Union became the world's second largest industrial economy. It gathered around itself a group of, mainly Eastern European, states with similar political and economic systems and formed its own separate world system with its own institutions and international division of labour.

In 1989 this system fell apart as governments friendly to the Soviet system were overthrown. In 1991 the Soviet system itself collapsed and the Soviet Union was dissolved. In this new situation the economies of the old system underwent a dual process: externally, they reintegrated into the dominant world system; internally, social ownership and economic planning were abandoned in favour of private ownership and the market.

Many of the new governments that came to power after the fall of the Communists were enthusiastic in their commitment to the principle of a market economy. For example Vaclav Klaus, prime minister of the Czech Republic, said, "Creating the conditions for the market to work and for private institutions to flourish can accomplish the economic and the social transformation ... [people will] change their patterns of behaviour and ... adjust their activities rationally and voluntarily if the market provides the right incentives" (quoted in King 2000). Politicians not sympathetic to market principles kept silent and yielded to international pressure to adopt reforms.

the Great post-Soviet Depression

Contrary to expectations, economic performance did not improve. In fact all the post-communist economies experienced acute problems³. Production measured in physical terms fell. Public services such as medical services, education and law enforcement deteriorated. Inflation was widespread. National income measured by real GDP fell. Unemployment rose. Birth rates fell and mortality rates rose. Life expectancy fell.

In this paper for reasons of space I will concentrate on the Soviet Union in the pre-1991 period and on the Russian Federation, or Russia as it is now known, thereafter. However something does need to be said about the fate of other economies caught up in the maelstrom.

Eastern Europe

Official figures show that decline in the GDP of East European economies was more severe than the impact of the Great Depression on those countries and only slightly less severe than the experience of the United States in Great Depression: typically GDP bottomed out at a level between 15 and 25 per cent below the 1988-9 peak, after dropping for 3 or 4 years. However, the recovery phase in Eastern Europe was far slower. In the US it took seven years for the economy to regain 97 percent of its pre-depression GNP peak. By contrast only two countries, Poland and the Czech Republic, were in a comparable position. The other four countries were in a far lower level.

	GDP Trough 1989 = 100	GDP after 7 years 1989 = 100	negative years out of 7
Bulgaria	69	69	5
Hungary	82	87	4
Poland	82	99	2
Romania	75	85	3
Czech Republic	85	96	4
Slovakia	75	84	4
US (1930-36)	71	97	4

From Lavigne 1999: 284 - 289

³ The only two countries that might in anyway has been said to have prospered, China and Vietnam, retained Communist governments together with the old political system and a good deal of the old state owned economy.

US figures for 1930 - 1936 from Lee and Passell 1979:364,369,371

National income statistics underestimate the impact of the hardship caused by the decline. The majority of the population suffered a substantial decline in living standards due to the withdrawal of welfare benefits (that had been considerable) and a general fall in real wages. In addition, unemployment, which formerly had been effectively zero, became a considerable problem.

The Labour market in 1996		
	real wages 1989 = 100	Unemployment
Bulgaria	45.7	12.5
Hungary	97.5	10.4
Poland	112.1	13.2
Romania	88.2	6.3
Czech Republic	102.3	3.5
Slovakia	88.2	12.8

From Lavigne 1999: 284 - 289

The index of US real wages for full time and part-time employees for 1936 was 108 (1929 = 100) (Kuczynski 1943: 150-4). Darby estimates that unemployment in 1936 was 17 percent. (cited in Lee and Passell 1979:371). Kuczynski quotes a figure for trade union unemployment of 13.3 percent. This compares with an average total unemployment rate 9 percent for the years 1923-27 (Kuczynski 1943: 138). In the United States the Great Depression was also the period of the New Deal: welfare benefits were being extended. When relief employees are included as part of the workforce the figure for unemployment falls to 10 percent (Darby Lee cited in and Passell 1979:371).

The former Soviet Union

The deterioration of the economic situation in the states of the former Soviet Union began slightly later than in Eastern Europe but proved to be both greater and longer lasting. There are considerable variations between the different republics, however even in the best areas the results have been grim. Some of the worse cases can be partially explained by local wars though it is open to question how far these are actually an effect of the economic collapse rather than a cause.

Index of GDP for 1995 from Popov (1996) (1990 = 100).

Armenia	38
Azerbaijan	34
Belarus	54
Georgia	17
Kazakhstan	45
Kyrgyzstan	42
Moldova	40
Russia	55
Tajikistan	40
Turkmenistan	63
Ukraine	40
Uzbekistan	83

As with the Great Depression of the 1930's it is less important to dwell on the misfortunes of the smaller states than it is to come to grips with the situation in the most economies. I will, therefore, ignore the plight of the other post-Soviet states and concentrate on Russia.

The Russian economic contraction was both precipitous and protracted. The initial phase from 1992 to 1994 saw a rapid decline. The next two years 1995-96 the rate of contraction slowed followed by a sign of a recovery in 1997. However this was not sustained and the decline continued in the following year. Since then only to revert to another big slide in 1998 followed by another partial recovery in GDP, though this was combined with a fall in personal consumption. Sustained growth in GDP and real incomes did not occur until the new millennium. Even today the majority of the Russian population are worse off than they were in Soviet times.

Lavigne gives Russian GDP in 1996 as 57 percent of the 1989 figure. (Lavigne 1999: 290-1) This is 62 percent of the 1991 total. Lavigne records growth of 1.6 percent for 1989 but negative figures thereafter. This gives seven consecutive years of contraction.

Interestingly, the official Goskostat handbook for 1998 only gives GDP figures in current prices. However it does give some indices of physical volume of production.

	All Industries
1992	75
1993	65
1994	51
1995	50
1996	48
1997	49

As in Eastern Europe there were considerable increases in inequality so that the living standards of the majority of the population declined substantially.

Lavigne gives Russian unemployment in 1996 as 9.3 percent. Real wages were 46.0 percent of the 1991 level. (Lavigne 1999: 290-1)

The cumulative effect of the cuts in living standards had a measurable impact on the health of the population.

“In 1992-1993, life expectancy at birth for the Russian population took an unprecedented fall. Between 1991 and 1992, Russian males lost 1.5 years in life expectancy and females lost 0.5 years. In 1993 the public health situation worsened so much that at first it seemed unbelievable. Between 1992 and 1993 life expectancy decreased by 3 years for males and by 1.8 years for females. By 1993, male life expectancy was 59 years, female life expectancy was 72 years. No country has exhibited such an abrupt change in peacetime.” (DaVanzo 1996) This step change in life expectancy continues to the present.

WHY DID IT HAPPEN?

As stated above, in my view Economists, both neoclassical and heterodox, seem to be confident that they understand what happened well enough: the chaos was mainly the result of the inherent weakness of the ‘Command economy’ (as Soviet planning system it is often called).

This confidence has some far-reaching implications both for policy and analysis. If things did not get better by moving away from the old system then this must have been because either the move was not radical enough (the default position for neo-liberals) or there was something wrong with the way the move was

carried out (the quasi-institutionalist position)⁴. Both positions share the premise that the market is superior to the planned economy.

Protagonists of these opposing positions rely on the argument that continuing problems of the former Soviet Union are to be explained by survivals of the old system. So, the Soviet system somehow lives on after its bones have been interred. At the same time another, and completely contradictory, concept is often introduced into the discussion: that of a non-system. This is the idea that while hyper-liberal policies have been successful in really destroying the old system to make room for the market, nothing has actually been put in its place. What we supposedly have is a *sui generis* state. This is called, variously, 'trans-liberalism', 'neo-primitive capitalism' (King 2000), 'wild-west-capitalism' or 'wild capitalism' ('dikii kapitalizm' in Nazpary 2002: 2) 'Kapitalizm' (Brady 1999), 'clepto-capitalism', and may other neologisms.

In my view these lines of argument are misconceived. As the greatest of the American philosophers, Will Rogers, said, 'It's not what folks *don't know* that's the problem; it's what folks *know for sure* when it *ain't so*.'

If the Soviet system was inherently inferior to the market, as it is generally accepted, then a change in the direction of the market should have produced better outcome. If one accepts the case for the market then the fact that conditions were less than perfect is irrelevant.⁵ The whole point about the market is that it releases individuals to pursue their own interests. This happens spontaneously and economists celebrate the ability of markets to develop and improve peoples' welfare in the most adverse conditions (see for example Radford 1945). Adam Smith himself explicitly rejected the notion that ideal conditions were necessary an economy to prosper.

In the Wealth of Nations Volume IV Smith criticised Quesnai for insisting that an economy "would thrive and prosper only under a certain precise regimen, the exact regimen of perfect liberty and perfect justice. He seems not to have considered that in the political body, the natural effort which every man is continually making to better his own condition, is a principle of preservation capable of preventing and correcting, in many respects, the bad effects of a political economy, in some degrees both partial and oppressive.. If a nation could not prosper without the enjoyment of perfect liberty and perfect justice, there would not be a nation in the world which could ever have prospered." (Smith 1976: 674)

The change in the direction of the market should have been a positive historicise that gave measurable boost to the economies that made the change over a lasting period. This did not happen (and, as far as most of the people involved are concerned, it still has not happened). On the contrary, there seems to be a negative historicise. Since the consensus view seems to be contradicted by experience then, if for no other reason than the pursuit scientific consistency, we need to consider the implications of abandoning the consensus.

Firstly, all the conclusions based on the premise that the Soviet system was inherently inferior to the market it are invalid. Since most of the discussion of the causes of the breakdown of the Russian economy are founded on this premise then most of the reasoning on this subject is void.

Secondly, we ought to consider other possibilities concerning the performance of the Soviet economic system. From the above it is clear that the null hypothesis - that a change in system would make no difference - is untenable. As I have shown, things did change: they got unambiguously worse over an extended period.

This leaves us with the possibility that the Soviet system, far from being inferior to the market, was in fact inherently superior. It is not necessary to claim that this is universally true, just that the Soviet system was

⁴ 'If the transition to modern economic capitalism failed in Russia because of an improper orientation to the role of the state in the transition, one obvious conclusion of this analysis is that a strong state is needed to lead development in post-Soviet societies.' (King 2000)

⁵ This is necessary for consistency. If lack of ideal circumstances were accepted as mitigation for poor performance of the market then defenders of planning could make the same plea to excuse the poor performance of their system.

inherently superior to the market in the concrete historical circumstances that existed when the change occurred. Of course, even this, limited admission that the Soviet economy was in some way successful, will be unpalatable to many. However, since both the generally accepted view (that the Soviet economic system was inherently inferior to the market economy) and the null hypothesis seems to be inconsistent with the evidence then the superiority of the old system to the market must be considered.

If it were the case that the market was the inferior system (i.e. it is unable to use the same resources as efficiently as Soviet central planning) then we would expect that a transition to a market system would lead to lower levels of the use of resources. This would explain both the immediate collapse and the long-term failure to recover.

The implication would be that the speed of the transition was largely irrelevant: it was the whole direction of the change that was the problem. Further, if the market was going to lead to lower levels of the use of resources then the current unsatisfactory state of affairs in Eastern Europe and the former Soviet Union could be explained simple in terms of a transition to the market.

In other words we could dispense with the notion that, despite the clear pre-eminence of the market in all areas of the economy and every day life, somehow market has still not yet arrived. It would also be unnecessary to dress up the, admittedly rather unpleasant, current operations of the market as anything other than that, and not the manifestation of some special stage.

Of course before these conclusions can be drawn a case must be made that:

- a) the old system did indeed disappear
- b) the catastrophe was essentially a post-Soviet phenomenon
- c) the Soviet system was viable and did not collapse due to its own inner economic weakness. In other words: there was no 'final economic crisis' of the planning system

there is an explanation for the If, there was nothing essentially wrong with it, why did old system disappear?

Did the old system survive?

Soviet style economies were characterised, internally, by an almost total predominance of social ownership (state or cooperative), an administrative pricing system and the allocation of resources by central planning; and externally by their closed nature: currencies were not exchangeable and international trade was a state monopoly.

None of these characteristics survived. The planning structures were dismantled, enterprises were freed to set their own prices and almost all state enterprises were privatised. Currencies now are exchangeable, enterprises are free to trade as they see fit.

In Russia, the new Russian government liberalised prices in January 1992. Privatisation was carried through in two phases. The first up until 1994 was done through a voucher system, the second 1994 to 1998 was through cash sales of shares. Of the 27,000 state enterprises that existed in 1993, 20,000 had been privatised by the end of 1995. The joint-stock company became the overwhelmingly dominant form of ownership (Kagarlitsky 2002: 192, 188). The state firms left over from the privatisation process were ones so uneconomic that no one wanted to take them on. Many workers 'on the books' of these firms did not work and receive no wages. Their employment was a pure formality which enables them to enjoy the few remaining benefits of the state sector (for example access to company medical services).

Under the Soviet system enterprises were typically large. In the new Russia many new, smaller, organisations were created. The number of enterprises grew considerably: In industry there were 61,100 enterprises in 1992. By 1997 there were 157,000: a growth of two times and a half times. In the economy as a whole the rate of increase was even faster. In the three years between January 1994 and January 1998 number of enterprises more than doubled, from 1,245,000 to 2,711,000 (Goskomstat 1998: 153, 160).

While it is true that large firms with a special relationship with the government play an important role such enterprises are clearly operating on commercial lines.

While it is true that large firms that had a special relationship with the government played a dominant role in the economy and were more efficient than the multitude of small firms this phenomenon is not entirely unknown in market economies.

How far was the catastrophe a post-Soviet phenomenon?

Whatever problems the old Soviet system may have had they were nowhere near comparable with those that developed after the end of the system. Standard works make great play of the problem of declining growth rates but firstly, they were *positive* rates – no one suggests that the Soviet economy did not grow – and secondly while the rates might have declined they did so from a very high base. Thus Western academic estimates of Soviet growth notorious ‘period of stagnation’ of the early 1980’s, were greater than official figures for growth of the Western European economies. (see Lane)

Such arguments are based on estimates of the size of the whole Soviet economy. There are, of course, some technical problems in producing such estimates. In addition given the natural bias of academics these were likely to be conservative estimates. More concrete measures of economic activity suggest that there was long-term growth in prosperity. Surveys by Soviet academics carried out between the early 1970’s and 1990 showed that:

“ ..the housing situation had improved; that the purchase of consumer durables had increased appreciably; that there were more recreational facilities for city dwellers; that many families had a private plot near their residence or in the neighbouring countryside (even though demand still outstripped supply). A third of the population had access to collective vegetable gardens.” (Lewin 2005: 366)

Further, against the current trend in the US and the UK, inequalities decreased. Moshe Lewin, for example, admits in his most recent book that surveys referred to above showed that:

“On the whole, the least well-off sections of the population had seen their incomes rise, attesting to a general trend towards decent minimum living standards. The most marked differences, as measured by key indicators like housing, incomes and personal means of transport, had decreased significantly.

These findings provide an explanation for the paradox of nostalgia amongst the population of post-communist Russia for the Brezhnevite ‘good old days’ .” (Lewin 2005: 366-67)

(For a comparison with Western living standards see also K. Bush (1982) ‘Retail prices in Moscow and Four Western Cities in March 1982’ RFE-RL 410/82)

Of course, such finding might easily be dismissed as being based on ‘tainted’ Soviet era data produced for propaganda purposes. However work on more objective, anthropometric data (heights, mortality, etc.) by B. N. Mironov in the post-soviet period supports the conclusion that there were continuing improvements in the ‘biological status’ of the Soviet population, for example improvements in the height of men continued until the 1980’s at least⁶. (Lewin 2005: 316).

Wheatcroft has also analyzed anthropometric data as a means of evaluating the performance of the Soviet system. He found that:

the Soviet situation combines a trend toward rapid secular improvement in welfare and life expectancy accompanied by short-term welfare and mortality crises related to warfare. The author concludes that welfare and mortality crises were not the totality of Soviet welfare and demographic experience under Stalin: apart from the crises, there was a rapid secular decline in mortality, a

⁶ C.f with the biological status catastrophe post 1991

swift transition from relatively short to relatively tall final heights, and from late maturation to early maturation. Stephen G. Wheatcroft, "The Great Leap Upwards: Anthropometric Data and Indicators of Crises and Secular Change in Soviet Welfare Levels, 1880-1960."

<http://www.visualstatistics.net/Catastrophe/Anthropometry/Anthropometry.htm>

This positive picture contrasts the demographic catastrophe that occurred under the market economy. DaVanzo has no doubt that conditions had been improving in Soviet times and the reversal occurred after the end of the system.

“Serious changes in living standards occurred in Russia in 1991-1992... Real per capita income, which was growing in the 1970s and 1980s, fell sharply by 40 percent and returned to the level of the early 1970s. However, it is possible that the living conditions of certain population groups are currently much worse than in the early 1970s because the distribution of wages in the population is now much less uniform. In 1993, the difference between the highest and lowest income deciles was 11-fold and about a quarter of the total population was below the official poverty level. In the 1980s, it was a five-fold difference....” . (DaVanzo 1996)

Was there a ‘final economic crisis’ of the planning system?

Gorbachev announcement that the Soviet economy was in a ‘pre-crisis’ state was greeted with surprise. This was partially because it was unprecedented for a Soviet leader to make such negative statements and partially because it contradicted the assessment of the best Western experts. For example, in 1980, Alec Nove, himself an implacable critic, was promoted to protest against the overly negative comments by some Western commentators:

" To repeat ..., there is no catastrophe imminent, the system is not in chaos, the quality of its planning and of its production are not in decline. Indeed, quality is actually improving. So, to take another example, is agricultural output, allowing for year-by year weather variations, though at a very high cost. Exclusive emphasis upon chaos and waste, the image of production of unsaleable rubbish, is misleading, especially if contrasted with the past, when the Soviet system was more wasteful, more inefficient, less productive. People have not become worse off." (Nove 1980:17)

The planned economy in the Soviet Union depended on two key elements:

- The formal planning structure coordinated by Gosplan and
- The All-Union Communist Party (CPSU) this had the personnel and the organisation to intervene continuously and at every level of the economy to ensure that any plan was carried through.

Under the leadership of Mikhail Gorbachev both these main elements of the planned economy were radically changed in their structure, function and personnel. These changes effectively destroyed the fundamental pillars of the planned economy.

The law on enterprises of 1987 that came into force from January 1 1988, effectively cut the wires connecting the levers in Moscow with the enterprises. Gosplan was deprived of its planning function and for all practical purposes it was shut down. The personnel who worked there were redeployed to other work.

Prior to this Gorbachev had already embarked on a reorganisation of the CPSU. In some ways it was more far reaching than the Ezovchina of 1937-8. A four fifths of the top Party leadership was replaced, nine tenths of the higher government positions and three-quarters of the leading posts at the republican and regional level. The new appointees did not always stay in post long. Gorbachev changed his personnel frequently. The Central Committee Secretariat was down-graded and its staff was cut by 30 percent. The Politburo stopped meeting regularly. (Suraska 1998: 44)

The net result was that well before the final political crisis of the summer of 1991, the organisational mechanisms for implementing planning decisions had ceased to exist: central planning was effectively abolished by decree from above.

"from the spring of 1989 the most important defining characteristics of a Communist system, whether structural or ideological, had ceased to apply." (Archie Brown quoted in Daniels 1999)

In the confusion of Perestroika the dissolving of the planning mechanism was largely overlooked. At the time reports in the West concentrated attention on the lack of progress of reform. Even now, nearly two decades later the important fact that the end of central planning preceded the dissolution of the USSR is not widely appreciated and receives slight recognition in the literature.

The conclusion to be drawn from this history is that these changes to the economy were not forced on Gorbachev by circumstances. They occurred while the economy was still functioning and before any decline. In other words there was no 'final economic crisis' of the planning system.

CONCLUSION

The transition from a central planning to the market can be modelled as a phase change from a more efficient to inherently less efficient form of economy. This inevitably results in less economic activity.

The timing of structural changes in the Soviet economy have implications for our understanding of the decline of its successor.

Following Gorbachev's reforms the old system ceased to exist. This left the economy in a metastable state that continued until the liberalisation of prices in January 1991. This, and other measures such as privatisation, triggered the precipitate decent into the alternative system – the market.

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