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A Speculative Essay

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Soviet Economic Transition: Getting From Here to There

A Speculative Essay

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Soviet Economic Transition: Getting From Here to There

Scope Note

This paper is not a coordinated Directorate of Intelligence product. It is a speculative paper that reflects the views of its author, which were developed in a continuing Office of Soviet Analysis seminar on the Soviet economic transition problem.

We have attempted to analyze how the Soviets could convert their existing economic system into a market system, including establishing free enterprise and widespread private property—the major preconditions of a market system. Our purpose was to improve our understanding of the problems Moscow would face in such a transition and to provide another perspective on the ongoing economic reforms in the Soviet Union

We believe that the plan we present addresses the major issues that the Soviets would have to face in transforming their economic system. However, actual transition would be unlikely to proceed according to the sequence of steps presented in this plan or any other. Real life would involve numerous missteps, delays, and feedback effects that would require considerable tactical maneuvering at a minimum.

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Soviet Economic Transition: Getting From Here to There

Summary

Information available as of 1 May 1990 was used in this report.

Modernization of the Soviet economy, in our view, depends on transition to an economic system in which free enterprise exists and most of the economy's assets are held privately. Although Moscow has not yet framed the issue in these terms, the severity of its economic problems is increasing the pressure to do so. To better understand the challenge that transition would pose for the Soviets, we have attempted to develop a set of policies and reforms that could help them make the conversion to a market system.

The Soviets could take many different paths to a market system, but they all must give a major role to privatization. Two basic approaches are possible: selling state assets or making grants of them at no cost. We favor the grants approach primarily because it would sidestep the bureaucracy, local authorities, and others with a vested interest in the existing system. A Soviet decree passed in 1988 that allows sales of state apartments to tenants, for example, has had virtually no response, in part because of resistance from local authorities. On the other hand, a grants program, accompanied by widespread publicity of its basic provisions, could enlist the public's participation and power to offset the resistance of officials.

We argue that rapid privatization is vital even though it might produce large disruptions initially. It would minimize the opportunity costs of maintaining the existing economic system. These costs include the continuing deterioration of the economy, as well as longstanding problems of massive waste and misallocation of resources. Rapid transfer of property rights from the state to citizens also would quickly give the public a stake in the new system and reason to hope for a better future

Our transition strategy would have two stages. The first would focus on market liberalization, whereby legal conditions would be established that free—and protect—private economic activity, subject to reasonably low taxes and some basic restrictions. Moscow could quickly provide a legal framework for business activity by adopting the uniform commercial code of West Germany or another country whose legal system has parallels with the existing Soviet system. This would save the large investment required to build a new code from scratch.

Stage two would focus on making grants of state assets to Soviet citizens. This could be done through legislation (or decree) that quickly provided clear title to state apartments to their current tenants and clear title to enterprises and farms to their current managers and workers as collective units. *Clear title would include the ownership right of disposal—the right to sell assets for a price mutually agreeable to the owner and the buyer.*

The collective units of managers and workers would then be authorized to determine whether the assets should continue to be held collectively or distributed to individuals. The government could provide ownership distribution models for guidance purposes. One model would be based on issuance and distribution of transferable shares to members of the collective. Another might be based on sale to a foreign—or domestic—investor, with proceeds of the sale divided among members. The final decision, however, would be up to the collectives themselves.

The law also would provide for grants to Soviet citizens *not* employed at enterprises or farms slated for privatization. Pensioners, for example, could be assigned to their former place of employment and provided the same rights as current employees. Others, such as housewives, public employees, or employees of industries remaining under state ownership, could be assigned to one of the enterprises or farms being privatized, according to a lottery system. They could receive either the same rights as an employee or just a partial set of them. As a result, almost every adult would participate in the program, which should garner widespread support for it.

The transition to a market economy would drastically alter the nature of governmental responsibilities in the Soviet Union. As a result of privatization, the government's present extensive role in organizing and directing economic activity at the enterprise and farm level would become redundant. Consequently, the economic ministries could be abolished, as well as the state committees for planning and pricing. At the same time, the government could focus on building new institutions, including agencies charged with administering the tax system and the banking system.

New social welfare institutions also would be needed, especially to deal with increased unemployment. Privatization would produce strong economizing incentives that would result in layoffs of extra workers. Emergence of a market system would stimulate the closing of obsolete or redundant plants and farms, which also would release labor into the unemployed ranks. Many other workers might have to settle for reduced wages.

The prospect that the Soviets would actually consider a strategy like the one we have developed is probably remote in the near term. While there is a consensus among the leadership and most Soviet economists that the current economic system should be abandoned, there is much less agreement on what the new system should be. Nevertheless, the last five years demonstrate a clear evolution in the reform process toward giving private ownership a greater role, and this trend probably will continue.

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Soviet Economic Transition: Getting From Here to There

Introduction

President Gorbachev, seeing the prospect of economic decline when he assumed power, quickly started a process of reform in an attempt to rectify the problem. After five years, however, the reforms have not only failed to achieve their aim but have also contributed to the disarray that now characterizes the economy. In so doing, they have replicated the record of previous reform attempts in the Soviet Union and other socialist countries.

Nevertheless, Gorbachev also has started a transition process that has gained a momentum of its own. *Glasnost*, the political reforms, and even the economy's increasing disarray have contributed to a deep discrediting of the existing economic system. A consensus seems to have emerged among the leadership and Soviet economists that the system is deeply flawed and must be changed, but there is much less agreement about the definition of the new system. Meanwhile, ideological and public opinion constraints—including those against private economic activity—that seemed unbreakable even one year ago are loosening and could be significantly relaxed in a short time, as is happening in Eastern Europe.

Soviet Options

Economic history indicates that Moscow's options for defining a new economic system are strictly limited. To put its choices in their simplest terms, we believe the Soviets must decide between preserving the current system of state ownership of most of the economy's resources or moving to an economy with a predominant private sector.

Reform economists in the Soviet Union and in other socialist countries have argued that the choice is not between state ownership and private ownership. Instead, they have proposed "market socialism" as a third way, which combines state ownership with markets. According to this view, markets will develop to guide enterprise managers, much as they do in Western economies, if central planning is replaced by enterprise managers making their own input and output decisions.

This system, although appealing in principle, has not worked in practice. In particular, proponents of this system appear to have greatly underestimated the persistence of governmental control of the economy under state ownership. They also have ignored the essential role performed by private ownership of capital and land in determining market prices for these resources and therefore for other goods as well.

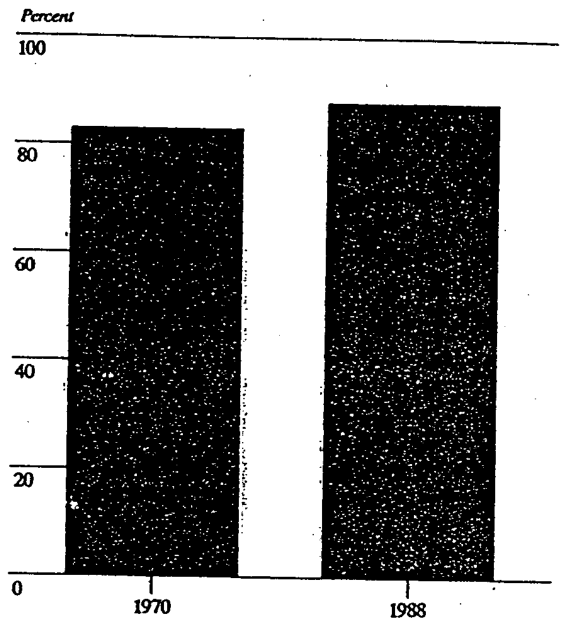
Hungary's experience with market socialism demonstrates the futility of attempting to debureaucratize an economy while maintaining state ownership of most resources. In 1968 Hungary abolished central planning and gave enterprises the formal authority to make their own production, sales, and investment plans. As de facto owner of most of the economy's resources, however, the central bureaucracy maintained its power to appoint and promote enterprise managers. Managers continued to owe their allegiance primarily to the center rather than to customers. Moreover, markets for capital goods and land could not develop because these assets remained almost entirely under state ownership. Although the role of market forces increased, a *market system* could not emerge.

The Hungarian experience does not, to be sure, *prove* that the Soviet Union could not apply the market socialism model successfully. We believe, however, that historical evidence as well as economic theory strongly suggests that, in attempting to introduce market socialism, the Soviets would run into the same problems as the Hungarians.

Poland and Hungary, after years of pursuing market socialism, have openly said that this was wasted time and that the aim of transition should be a Western-style market economy with a predominant private sector. Some Soviet economists and reformers are now making similar arguments.

We believe that, like Poland and Hungary, Moscow also will eventually have to choose between economic stagnation or decline, or movement to a largely private ownership system. The end point of transition might be a *mixed* economy resembling many of those in Western Europe and elsewhere. The state would maintain ownership of railroads, the telephone system, utilities, and other "natural monopolies," where a case for state ownership can be made, but the rest of the economy would be in private hands. Moscow has not yet framed the issue in these terms. Nevertheless, the discussion we present below examines policies and measures it could follow to develop a large private sector, if it were to pursue this aim.

USSR: Extent of State Ownership of Fixed Capital[a]



[a] Probably includes housing.
Source: Ryzhkov's speech to the Supreme Soviet, 2 October 1989.

Preconditions for Transition

As a first step in attempting to describe a strategy for economic liberalization and transfer of state assets to private ownership in the USSR, we have examined some key political and economic conditions that could set the stage for such a strategy. This approach provides a useful way to think about some of the many issues involved in transition. We do not believe, however, that the process must proceed in this fashion to succeed. There are numerous uncertainties and many different paths would be possible.

Major Political Changes

Communist domination of the government represents an important barrier to developing a market system, since Communist ideology is built around a moral rejection of private property. In addition, the power base of party and government elites largely derives from state ownership, and both groups will resist development of a large private sector on this count as well.

President Gorbachev's democratization strategy has resulted in a sharp diminishment in the political power of the party apparatus in favor of government institutions. Elections, a strengthened presidency, and the repeal of the party's constitutionally mandated leading role all have served to reduce the party's position. Moreover, grassroots demands for greater democracy have prompted the recent retirements of party officials in Volgograd, Sverdlovsk, and other provincial centers. How much further this process would have to proceed before Communist party power would no longer constrain privatization is uncertain, but Gorbachev seems intent on further limiting the party's role.

Getting Really Radical

Larisa Piyasheva is a Soviet reform economist who studied Western economics for many years. She has emerged on the scene of the economic reform debate with probably the most extreme views yet published on the institutional and policy changes required for transition. For several years she published under a pseudonym but since 1989 has begun using her own name. [redacted] *her views are increasingly finding resonance in the USSR.*

Piyasheva advocates wide-scale privatization of ownership of the means of production and land in all regions of the USSR, the abolition of central planning organization and economic ministries, a program for protection of private businesses, and slow growth of the money supply. Moreover, she has strongly criticized the government's current economic plan developed by Leonid Abalkin, Chairman of the State Commission for Economic Reform. Piyasheva views this plan as largely comprising half measures and envisioning a transition to "the kingdom of new socialism with a second wind." According to [redacted] *she believes that the next round of reforms could include her ideas.*

[redacted]

The public's views toward private property would be an important factor for a leadership considering privatization. *Glasnost* has underscored the many flaws of central planning and has done much to persuade popular opinion of the need for reform. The debate on property rights and new legislation on property are also increasing the public's awareness of these issues. The increased access of the population to information on living standards and working conditions in Western private enterprise economies may be strongly influencing public opinion as well.

The results of Soviet opinion polls have to be interpreted carefully because of possible methodological problems. Nevertheless, some indicate surprisingly strong support for a system based on private ownership and markets. If Poland or other East European countries make significant economic gains from privatization programs, public support for private property probably will grow.

Another important factor influencing public opinion toward privatization will be the state of the economy in the next few years. Poland, for example, is now engaged in implementing radical economic measures following at least 10 years of poor economic performance, worsening corruption, and expansion of the underground economy. By 1989 a large fraction of the population was engaged in the private sector, and many of those who were not so involved had probably concluded that preserving state ownership was useless. According to official Polish data, private-sector activity represented 25 percent of personal money income in 1986, but one Western analyst estimates the actual figure at 38 to 45 percent after taking account of the underground economy and making other adjustments to the official data. Such developments helped to create widespread public demand for radical changes. The Soviet economy may have to follow the same path as Poland before public opinion is ready to accept the hardships of dismissing state ownership and moving to a market system.

USSR: Results of Guardian-Newsnight Poll Concerning Approval of Private Ownership

Percent

Could you tell me whether you personally approve or disapprove of the creation of privately owned industries, operating according to the rules of market economics?

	Fully Approve	Partially Approve	Partially Disapprove	Fully Disapprove	Don't Know
Moscow	43.0	21.0	21.0	5.7	9.2
Leningrad	46.7	13.6	15.8	8.3	15.6
Gor'kiy	33.1	20.4	10.4	19.8	16.4
Irkutsk	35.5	28.5	11.2	7.0	17.6
Alma-Ata	45.7	18.5	17.2	9.0	9.5
Tallinn	54.7	20.8	8.4	3.7	12.1
Average	**43.2**	**20.5**	**14.0**	**8.9**	**13.4**

Source: *The Guardian*, 6 March 1990. The polling of almost 3,000 people was conducted by the Soviet Institute of Sociology of the Academy of Sciences between 22 and 25 February 1990.

Achieving a Sound Currency

The Soviet economy currently faces substantial inflationary pressure brought on in large measure by high budget deficits starting in 1986. The deficits have caused the money supply to grow rapidly in comparison with the volume of goods and services. We estimate inflation for consumer goods and services in 1989 reached 8 to 10 percent. Rapid money supply growth also has resulted in the accumulation of a large stock of rubles by households and enterprises, since the administered price system has prevented full adjustment through inflation. This overhang of purchasing power has contributed to shortages of consumer goods at state stores, barter, rationing, hoarding, and expansion of the underground economy. Consequently, the ruble is losing its ability to serve as a credible means of exchange.

The weakness of the ruble would complicate undertaking a large-scale privatization program. In particular, the excess supply of rubles probably means that, in a transition period, newly private enterprises would be able to charge much higher prices than those currently fixed by the state. If so, the population would tend to blame the private sector for charging higher prices, even though the outmoded official price structure and errant fiscal and monetary policies would ultimately be at fault. The political backlash could jeopardize the privatization program. Gorbachev's major initiative for encouraging private economic activity ("cooperative" private businesses) already has faced substantial criticisms for bringing high prices, and, in response to these criticisms, new restrictions on the cooperatives have been imposed by the central authorities.

Given the potential for a backlash, it could be argued that Moscow should reduce the real amount of rubles in the economy before embarking on a full-scale privatization program. More important, by the same reasoning, the budget deficit should be reduced, since it is a major cause of the rapid growth of the money supply. The problem, however, is that the policies most widely proposed to achieve these goals also risk popular unrest, directed at the central government:

- Under one proposal, centrally administered prices would be raised high enough—40-percent increases have been suggested as necessary—so that balance is restored between the real money supply and the volume of goods and services in the economy. As part of this policy, consumer subsidies also would be reduced, which would cut the budget deficit and the growth of the money supply. These steps, however, would risk popular reaction that focuses blame for the price hikes on the government.

- Alternatively, the "money reform" proposal suggests that Moscow should confiscate a large portion of the outstanding supply of money in the economy through a currency exchange, in which old rubles would have to be exchanged for new ones at adverse rates. Moscow apparently has considered this option but has rejected it because millions of small savers, as well as those with large holdings, would have to suffer losses to make the policy effective

There probably is no painless solution that can resolve the budget deficit and the ruble overhang problems.[1]

Moscow's best option might be to raise prices, but to do so using a variety of means so that the responsibility for inflation is parceled out among a number of actors. For example, the government could increase the range of goods sold in retail stores at market prices. Moscow could also tolerate increased price hikes by state enterprises and implement some official price increases from the center, including those on heavily subsidized food items. Moreover, implementation of a privatization strategy would complement this approach, since new private enterprises charging high prices also would absorb some of the blame for inflation.

Moscow has proposed measures in the last year that would result in more state goods selling at market prices. In January the government attempted to expand the existing system of auctioning consumer goods, and in August 1989 Leonid Abalkin, Chairman of the State Commission for Economic Reform, indicated that prices on fruits and vegetables would be completely decontrolled. Other similar measures probably are under consideration, including establishing a new tier of retail stores that would sell goods at close to market prices. Moscow also has raised prices for some key goods. The price of gold jewelry was increased in January by 50 percent, and the price of hard currency for Soviet travelers was increased by 10 times in November 1989.

The Means of Transition: Assigning Private Property Rights on a Massive Scale

Transforming an economic system based on state ownership to one based on private ownership is a herculean challenge, unprecedented historically. The revolutions in Eastern Europe in 1989, however, have made this a real issue rather than a theoretical one. Poland, Hungary, East Germany, and Czechoslovakia all have indicated an intention to privatize. As a result, a growing number of transition plans are being proposed both in the East and the West.

[1] Selling state-owned apartments to their tenants has been suggested by a number of Soviet economists as a painless way for the government to eliminate the ruble overhang. Indeed, there is a new decree on the books that allows such sales. This proposal, however, is unlikely to raise much revenue under current conditions. First, many tenants probably would not participate because their rent is almost free. Second, many tenants probably have little or no savings. Even if they wished to buy an apartment and were allowed to do so with no downpayment, their participation would not diminish the overhang. Finally, the program's success would depend on the bureaucracy's taking pains to make it work, rather than being obstructionist. We argue it is better to sidestep the bureaucracy by *granting* clear title to tenants, which quickly would produce a housing market, foster civil society, and increase labor mobility.

The privatization strategy outlined below for the USSR takes account of some of these plans, but goes beyond them in a number of respects. In particular, the strategy we present gives much higher priority both to sidestepping the bureaucracy and to rapid change. The bureaucracy is unlikely to ever take a positive view of privatization and indeed is likely to be obstructionist. A strategy that requires little or no support from the bureaucracy therefore would have a much greater chance of success.

A fast pace of change would minimize the opportunity costs of maintaining the existing system. These costs include the continuing deterioration of the economy, as well as longstanding problems such as massive waste and misallocation of resources. Rapid change also would quickly give the public a stake in the new system and reason to hope for a better future, despite initial hardships.

In developing our privatization strategy, we also were guided by several other considerations:

- The Soviet population probably includes a substantial number of would-be entrepreneurs, and a large number of workers are likely to tolerate—if not welcome—private property and private hire of labor, given the opportunity to earn higher real incomes.
- Sophisticated banking, antitrust, and stock market institutions that have developed over decades in market economies are not essential for the transition from a bureaucratic to a market system. In our view, these are long-term results of a system of private property rights and market coordination—not causes of, or preconditions for, a market system.
- The likely presence of powerful monopolies among newly privatized Soviet enterprises, although not a negligible problem, need not be a critical stumbling-block to the economy's privatization

We have outlined two stages of a prospective privatization program, consisting of a sequence of steps that (1) liberalize Soviet markets and (2) turn over state assets to private owners

Is Monopoly Power a Major Problem?

Many enterprises in the Soviet economy are exclusive producers of goods as a result of decades of central planning. Consequently, privatization of such enterprises would grant the new owners and managers substantial monopoly power

However, the problem of monopoly power is often overestimated, in our view, because other important sources of competition are overlooked, and the benefits of monopoly power are discounted. Other sources of competition include the foreign sector, consumers' ability to substitute one good for another, technological change, and the prospect that high profits will attract new entrants into the monopolist's market. A major benefit of monopoly power is that large retained profits provide firms with financial resources to modernize plant and equipment, carry out research, and expand capacity. Such resources would be in short supply if the government tightly restricted credit issuance and investment subsidies as part of a policy to curb inflation and cut the budget deficit.

Stage I: Market Liberalization

The objective of the first stage would be to free individuals to set up businesses and make transactions, subject only to reasonably low taxes and basic legal provisions concerning commercial contracts, working conditions, pollution, and, for some goods, minimal quality standards. Major changes in the constitution of the USSR could be enacted to guarantee rights of private property, free enterprise, and other civil rights. Moscow could quickly provide a comprehensive legal framework for business activity by adopting the uniform commercial code of West Germany or another country whose legal system has parallels with the existing Soviet system.[2] Private-

[2] Moscow has enacted laws on cooperatives and individual labor activity that have expanded the opportunities for private economic activity. A new law on property has been passed that advances private property rights. A new law on joint ventures also has been drafted. However, such legislation represents piecemeal and cautious reform, according to US attorneys familiar with the Soviet legal system. They argue that the USSR needs a comprehensive and integrated system of business law and that the least costlv method to obtain such a system is to borrow it from abroad

sector prices and wages would be free of state controls.

These measures would allow merchant-entrepreneurs to establish trading businesses and also would provide the basis for private enterprises of all kinds.[3] Merchants would create markets—both retail and wholesale—and numerous new distribution channels would be formed. At the same time, although most credit and resources would still be under state control, many other new enterprises could still be created that would need only minimal inputs. In particular, many businesses could be formed to provide services to consumers and state enterprises, with an initial investment of not much more than the entrepreneur's organizational talent, a group of skilled workers, and basic tools and equipment.

Legalization of private trade in foreign exchange would facilitate at least some growth of foreign trade and joint ventures. The opportunity to purchase Western goods, even at extremely high prices in domestic rubles, would produce strong incentives for Soviet entrepreneurs and workers.[4] Moreover, imports would represent a key source of competitive pressure, of importance in the second stage of privatization, when state enterprises with significant monopoly power would be turned over to private owners.

Stage II: Transfer of State Assets

The second stage of privatization would consist of the actual transfer of state assets to private citizens. This would represent an immense political and economic challenge. In the United Kingdom during the 1980s, Prime Minister Thatcher sold 18 state-owned companies to the private sector, but even this was a difficult task. By comparision, the Soviet economy has 46,000 state enterprises and more than 50,000 state and collective farms. There also are scores of thousands of state construction, trade, and service enterprises.

Ruble Convertibility

In many countries, convertibility of a currency into foreign exchange is restricted by government controls. These controls are often meant to restrict the outflow of domestic capital, produce government revenue, or influence the mix of exports and imports. Within the country's borders, however, domestic currency usually can be widely used to purchase goods and services. In these cases, the path to convertibility is clear—it largely consists of eliminating exchange controls, often in conjunction with reining in a budget deficit and slowing the growth of the money supply.

The situation is much different in the USSR, since the ruble lacks convertibility in the domestic economy. Central administrators largely determine the distribution of producer goods among enterprises on the basis of plans and issuance of official permits, not rubles. Similarly, it is currently illegal to buy consumer goods for resale to others, and rationing of consumer goods is widespread.

The key condition for convertibility of the ruble into foreign exchange is therefore first making the ruble convertible into domestic goods and services. This condition would be partially met if private-sector activity were liberalized. Foreigners, as well as Soviet citizens, would be able to freely purchase goods and services from the expanding private sector. Foreigners would need to exchange their currency for rubles, and a market for rubles would emerge.

The ruble would be only partially convertible since it still could not be used to purchase goods and services from the predominant state sector. Full convertibility would have to wait on the transfer of state assets to the private sector (stage II).

[3] New regulations issued in 1986-87 and a law enacted in 1988 have resulted in a rapid growth of the Soviet private sector in the form of cooperatives. According to official statistics, there were 5 million persons employed in cooperatives as of 1 April 1990, compared with 15,000 at the beginning of 1987. This expansion is remarkable considering the ambiguities in the legislation and the bureaucracy's bias against private activity. It suggests the large potential of the private sector that could be realized if a clear-cut set of rules were established and a bias emerged in favor of private activity

[4] The high demand for imports would translate into high demand for hard currency, putting great pressure on the ruble. According to a recent article in the Soviet press, the black-market exchange rate for the ruble already has fallen to 30 rubles per US dollar. The rate probably would fall even further under liberalization. On the one hand, the low value of the ruble would limit balance-of-payments problems; on the other hand, it would create opportunities for very high profits by diverting exportable goods from the state sector to the private sector. It would be important to privatize quickly to limit these large incentives for corruption

There are basically two mechanisms available for privatization: sales and grants (distribution at no cost). A pure sales approach would distribute state assets to the highest bidders. A pure grants approach would distribute assets for free on the basis of noneconomic criteria. Many variations of these mechanisms would be possible, including some that combine the two.

Under the sales approach, a government agency would probably be needed to organize and guide the program. Assets would need to be appraised, shares would have to be issued and sold, auctions might be needed, and financing might need to be arranged. Poland, in its transition plan, calls this the Office of the Plenipotentiary for Ownership Transfers. Hungary plans to call this body the State Property Agency.

However, governmental regulation probably would mean drawing out the process over a number of years, when speed is very important. The planning bureaucracy, local authorities, and others with a vested interest in the existing system would be unlikely to stand aside and let sales occur without their intervention. The problems of valuing state assets and financing sales are both complex and time-consuming issues, as shown by the history of privatization in the United Kingdom and elsewhere. Moreover, the sales approach probably underestimates the ability of the *nomenklatura* and others to enrich themselves through manipulating the program, a problem that Hungary and Poland already have experienced.

Governments have used a variety of means throughout history to grant state-owned property to citizens. Most of these cases involved land. Assignment of ownership rights to tenants (land reform) and to homesteaders are examples. Economic history, however, offers no precedent for the Soviet privatization challenge, which would involve not only land but also vast industrial assets.

Nevertheless, in our view, giving away the state's assets is preferable to attempting to sell them, primarily because the grants approach would not require the cooperation of the bureaucracy nor entail the problems of valuation and financing sales. Such an approach would rely on widespread publicity to make the public aware of the basic provisions of the program and then largely allow the populace itself to carry those provisions out.

For state-owned enterprises and farms, a law (or government decree) would state that, as of a certain date, clear title to state assets of a firm are to be given to the managers and workers as a collective unit. *Clear title would include the ownership right of disposal—the right to sell assets for a price mutually agreeable to the owner and the buyer.*[5] It would then be up to the collective to determine whether the assets should continue to be held collectively or distributed in some form to individuals.[6] The law would specify strict guidelines on the decisionmaking process (for example, one-person/one-vote).

[5] The conveyance of this right is a *necessary* condition for the formation of markets in capital and land.

[6] A decision to maintain collective ownership would produce firms similar in some respects to those in the Yugoslav system of worker management. The key difference, however, is that, in the model we present, the collective would have the property right of disposal—the ability to sell, rent, or otherwise change the form of ownership of the firm's assets. Under the Yugoslav system, this right is retained by the state, and thus workers are encouraged to extract the value of the firm's assets through higher wages and disinvestment. This incentive would be largely absent if the collective has the ability to dispose of assets and compensate members.

The government could provide two or three different ownership distribution models for guidance purposes. One model would be based on issuance and distribution of transferable shares by the collective to individuals within the collective. Another might be based on sale to a foreign—or domestic—investor, with proceeds of the sale divided among members of the collective. It would be up to the collectives themselves, however, to choose the model they want.

The law also would provide for participation by Soviet citizens *not* employed in enterprises and farms slated for privatization. Pensioners, for example, could be assigned to their former place of employment and provided the same rights as workers. Others, such as housewives, public employees, and employees of industries remaining under state ownership, could be assigned to one of the enterprises or farms slated for privatization according to a lottery system. These persons could be given the same rights as an employee of the enterprise or farm, or just a partial set of them.

For housing, the state would assign clear title of state apartments to their tenants, at no cost.[7] Such transfers would immediately make millions of citizens the owners of private housing, foster civil society, and cause the development of a housing market. The zero cost not only would avoid the problem of trying to value state apartments, but also would take account of the very low rents that tenants currently pay. Many tenants would have little interest in borrowing to buy an apartment, since even a low sales price could mean a mortgage payment that exceeds monthly rent by a factor of two or more.

Under this approach, almost every adult in the country would become an owner of assets, although the resulting distribution of wealth surely would be unequal. However, any distribution is bound to be unequal. Moreover, the majority of the population might find this approach fair because it largely amounts to a giant lottery.[8] An individual's gains would basically be a matter of luck, depending on where one happens to live and be employed, as well as on the value of the assets *after* the emergence of a market system. For example, market pricing could make the assets of a rundown plant producing a consumer good in high demand very valuable, while many heavy industry plants might emerge with low values because of low demand for their output.

The government's role would be largely limited to enforcing the guidelines on the decisionmaking process, issuing titles, and managing the lottery system for those who are not employees or pensioners of privatized enterprises and farms. As a result, the program could be carried out quickly. Probably not more than a year would be required for collectives to decide on, and carry out, an ownership plan.

New Governmental Challenges

The transition to a market economy would drastically alter the nature of governmental responsibilities in the Soviet Union. As a result of privatization, the government's present heavy role in organizing and directing economic activity at the enterprise and farm level would become redundant. Consequently, the economic ministries could be abolished, as well as the state committees for planning and pricing. At the same time, the government could focus on building new institutions, including agencies charged with administering the tax system and the banking system.

[7] On Gorbachev's trip to Sverdlovsk in April, Soviet television showed an exchange between the Soviet President and an official of the giant Uralmash enterprise in which Gorbachev stated that workers ought to be given their apartments free. This is the first official indication we have seen that such a policy is under consideration.

[8] It can be argued that such a distribution of the country's assets is unfair because some individuals would receive more valuable assets than others for no other reason than happening to be in a certain place at a certain time. The alternative of selling the assets, however, would give the inside track to the *nomenklatura*, organized crime, and black-marketeers, while leaving the substantial share of the population with no savings out of the picture. Moreover, the sales approach ignores completely the vast contribution the whole population has made to financing the formation of state assets through the tax system, low wages, and low living standards. The privatization method we present recognizes the public's role in formation of these assets by ensuring that almost every adult would receive a claim of some kind on state assets.

New social welfare institutions also would have to be formed. The existing economic system has a large social welfare component based on job guarantees, low prices for food, and large subsidies to state enterprises and farms. Transition to a market economy would largely eliminate these provisions, and new ones would be needed.

Moreover, the need to provide support for large numbers of unemployed workers could emerge quickly once privatization began:

- The transfer of ownership rights from the state to individuals would produce powerful economizing incentives that would result in layoffs of many workers.
- The formation of a market system would stimulate the closing of many obsolete or redundant plants and farms. Just as many workers in heavy industry in Western economies have had to move to new jobs, so would many Soviet workers, although the scale of employment shifts required would undoubtedly be much greater.[9]
- Finally, the abolishment of economic ministries and other agencies would result in the layoff of many government workers.

In response, the government could create a system of unemployment benefits. The Supreme Soviet already is considering a draft law on employment that calls for 26 weeks of unemployment benefits and provision of an "employment fund" that would finance publication of job vacancy information and retraining. However, benefits could be very low, given the need to restrain government spending and the many workers that may eventually need aid.

Inflation also would probably be a feature of the transition period. Provisions such as indexing of incomes and rationing could be made for pensionsers and others dependent on fixed incomes.

[9] Labor mobility currently is restricted by the shortage of housing that exists across much of the USSR. However, the grant of clear title of state apartments to their tenants would allow the development of a nationwide housing market that would greatly expand the opportunities for workers to move, even without an increase in the stock of housing

The Western Role in Transition

Moscow probably should make full integration into the world economy one of the primary goals of its transition strategy. Such openness would encourage improved efficiency of domestic production through Western investment and imports competition. Investors would bring with them technology, management skills, and access to foreign markets, which are in scarce supply in the USSR today. Imports would represent an important source of competitive pressure for domestic producers and generate substantial incentives for workers starved for modern consumer goods.

Under the privatization plan we have presented, some work collectives probably would choose to sell their assets to a foreign investor. However, foreign investors might primarily be attracted by the opportunity to build new production facilities. Very low labor costs, a large consumer market, and the economy's need for massive reconstruction would attract foreign capital and entrepreneurs from around the world—as long as they could gain clear title to assets, buy and sell rubles and domestic goods and services, and basically face the same laws as domestic firms. Indeed, the level of foreign interest in the Soviet economy would be an excellent barometer of liberalization.

Outlook

While a consensus among the leadership and Soviet economists on the definition of the end point of economic transition has not yet emerged, the last five years demonstrate a clear evolution in the reform process toward giving private ownership a greater role. The political and institutional obstacles remain huge, but a decision by Moscow to focus on large-scale privatization is not as remote a prospect as it seemed just a few years ago:

- The prestige and authority of the Communist Party have declined substantially since 1987.

A New Economic Adviser

President Gorbachev appointed Nikolay Petrakov as his personal economic adviser in January 1990. Petrakov is committed to developing a market system in the Soviet economy, and his appointment is a signal that Gorbachev intends to move in the same direction. Petrakov recently was quoted by a Western reporter as saying, "We should turn all state property over to shareholders and create a stock exchange." He also indicated that higher prices are needed to balance supply and demand in the consumer market and that "some prices will be very high, but these products will at least be available on the shelves of the shops."

According to [redacted] Petrakov also will head a new USSR Academy of Sciences Institute of the Market. The institute will be made up of about 150 professionals and 50 support staff. Its mission will be to study competition, prices, supply and demand, convertibility, "and all those subjects connected with the transition to a market economy." As [redacted] with Petrakov heading this new office, it will also be able to carry out staff work for Gorbachev.

Although Petrakov seems to believe strongly in the advantages of markets, his proposals for establishing them do not yet include a major role for private property. He possibly feels limited in how far he can go in discussing privatization. Alternatively, he may accept the market socialism model, which would preserve state ownership of most resources but do away with central planning and give a greater role to financial levers, including prices

- President Gorbachev has garnered substantial new powers, independent of the party, which could allow him to pursue a tough stabilization program and radical reforms adverse to party ideology.

- Consumer market disarray and the decline of economic coordination among industries are creating pressures for radical change.

- The revolutions in Eastern Europe are leading to the adoption of economic transition programs that emphasize privatization, and these programs are being monitored in Moscow by a leadership virtually desperate for economic policy guidance.

A number of recent signals indicate that President Gorbachev is considering a new set of reforms: the appointment of Nikolay Petrakov as his personal economic adviser, Gorbachev's inaugural speech indicating he intends to use his new powers to further economic reform, and official reports that a new package of measures is under consideration. There is still no evidence, however, that privatization will be a major element of reform in the near future. Nevertheless, we expect that inexorable pressures—political, economic, and intellectual—probably will push the Soviet reform process in the direction of radical change, including giving a central role to privatization.