1

Perestroika—The Great Awakening: 1985–87

For that they all perish!

— Popular toast about the Soviet leaders in the 1980s

We can no longer live like this!

— Mikhail Gorbachev to Eduard A. Shevardnadze in 1984

In November 1984, I was driving from Helsinki, Finland, to Moscow. No border in the world marked a greater divide than that between Finland and the Union of Soviet Socialist Republics. In Finland, all was modern and wealthy. When you crossed the border into the USSR you stepped 70 years backward into history and poverty. The Soviet frontier regions looked as if nothing had changed since World War II. Only decay and grayness had proceeded.

Police supervision along the road was extraordinary, as this was one of the few Soviet roads open to foreigners, who were kept from seeing anything but a few carefully selected and cleansed show places, such as Moscow and Leningrad. We had to apply for a visa for every road we traveled. The number of crossroads was small, but a police station guarded each of them. Every time we reached a crossing, the police called the next checkpoint to report that we had been there. Once, we took a break on the road. Within ten minutes, a police car approached us, and we were commanded to drive again. Didn't we know that we were not allowed to stop? Many police officers halted us seemingly just for the sake of it. Their demeanor revealed that they ruled the land. Even so, soon after passing the border we were hailed down by some men in the dark. Presuming they

Peterson Institute for International Economics | www.petersoninstitute.org

were policemen, we halted, but at the last minute we realized they were robbers and sped away.

This was the "highway" that connected the two biggest cities of the Soviet empire, Moscow and Leningrad. Yet it had only two lanes and was marred by potholes. Traffic was minimal, because the Soviet Union never developed mass car ownership, and travel was severely restricted. From time to time, a sign informed us "telephone 30 km," because ordinary villages had no phones.

One little village followed after the other, with their quaint Russian wooden cottages. They were almost indistinguishable and would have been romantic had they not been so dilapidated and unpainted. Ice clung to the windows. One village was tellingly called *Chernaya gryaz*—"Black Dirt." In each village, a stooping babushka carried a heavy yoke with two buckets of water, because there was no tap water or sewage. Admittedly, they had electricity, and television spread the regime's imbecile propaganda of success amidst this disheartening poverty. I sent a sympathetic thought to Alexander Radishchev, the Russian 18th century dissident who was exiled to Siberia for seven years by Catherine the Great because of his miserable observations in his 1790 book, *Journey from St. Petersburg to Moscow*.

The biggest secret, hidden from both the Russian population and the West, was that the Soviet Union was a Third World country, successfully parading as a superpower, which it was in one single regard, namely military might. The Soviet foreign policy specialist Aleksandr Bovin coined the somewhat exaggerated but apt phrase "Upper Volta with nuclear arms."

In 1983, Zbigniew Brzezinski observed, "The Soviet Union is a world power of a new type in that it is one-dimensional . . . the Soviet Union is a global power only in the military dimension" (Brzezinski 1983, 12). Tellingly, the militaristic Russian nationalist Aleksandr Prokhanov agreed: "One could say that until the Soviet Union achieved military-strategic parity with the West, the USSR had no other national goal than that of survival and defence."[1] Once, on the train from Moscow to Warsaw, a Russian woman from the provinces told me how fantastic Moscow was: You could even buy oranges there!

Soviet society was standing still, but in 1985 change erupted that led to a revolution. This chapter first discusses why Gorbachev's economic reforms, perestroika (literally: restructuring), began. The explanation lay in the contradicting demands of the arms race with the United States, and a stagnant economy. A new generation of leaders emerged. Although impressive in many ways, the severe limitation of the Brezhnev system had made them quite parochial. The new general secretary of the Communist Party of the Soviet Union (CPSU), Mikhail Gorbachev launched economic

1. *Detente,* nos. 9–10, 1987, 26.

Peterson Institute for International Economics | www.petersoninstitute.org

reform on a broad front, but as this chapter shows, his many efforts led to minimal improvements.

As a reaction to the failures of his initial economic reform, Gorbachev tried to open up the public debate through "glasnost" (openness), and he allowed public criticism against the old system to escalate. Gorbachev also launched an active foreign policy called "new thinking" to reduce high military costs, which was one of the greatest successes of his early reform efforts. A frequent criticism of Gorbachev is that he should have opted for the same kinds of economic reforms that the Chinese had done, but the problem was rather that he tried similar reforms while the results were far worse because of completely different preconditions.

Why Perestroika Started

No place was as petrified as the Soviet Union in the early 1980s. Leonid Brezhnev, who ruled as general secretary of the CPSU from 1964 to 1982, abhorred change. He ended the circulation of staff, leaving everybody in the same post for years. Officials did little, because no initiative was appreciated by the rulers. They just grew older. By the early 1980s, the Soviet leadership was an inert gerontocracy ridiculed by all. The average age of the ruling Politburo members had risen above 70, while the average life expectancy for men was 63 (Brown 1996). The Soviet Union was ruled by dying people. Throughout the state and party administration, high office holders never retired but occupied their posts until they died, impeding all promotions. By 1985, many ministers and regional first party secretaries had held the same job for two decades.

The main political events were ornate funerals on the Red Square accompanied by Frederic Chopin's "Funeral March." In a quick sequence, the music played ever more frequently: Brezhnev died in November 1982, his successor Yuri Andropov in February 1984, and his successor Konstantin Chernenko in March 1985, not to mention other Politburo members. Sarcastically, Russians joked about "Five Years of Fancy Funerals" (*Pyatiletka Pyshnykh Pokhoron*).

The inertia was mind-boggling, and the public perception was that nothing could change. The carefully censored official data indicated that the economy and welfare were growing moderately but steadily. The only apparent concern was that the Soviet Union was locked in a nuclear arms race with the United States, which cost the country an ever larger share of economic output.

By its own standards, the Soviet regime did well in domestic politics. The Communist Party was the only game in town, and the domestic political scene was exceedingly calm and stable. The Soviet Union was a secret police state with ample means of repression, thousands of political prisoners, and complete censorship, but it did not need to apply much

Peterson Institute for International Economics | www.petersoninstitute.org

force, because people saw no hope for change. By and large, state terror had ended with Joseph Stalin's death in 1953, and an implicit social contract developed. As long as people did not express any political views in public or have contact with foreigners, they had jobs and could live in peace in their tiny apartments.

Political dissidents, human rights activists, and nationalists of many stripes persisted, but they posed no systemic threat to the regime. Tens of thousands of Jews and dissidents were allowed to emigrate to the West. The authorities tolerated some nascent popular movements for the defense of the cultural, historical, and environmental heritage. One of the most vibrant cultural movements centered on "village prose," which gathered Russian nationalists cherishing traditional rural life (Parthé 1992).

But the pacification of the population gave rise to social problems such as demoralization, alienation, and apathy, breeding a widespread sense of social, cultural, and ecological decay. This demoralization aggravated a staggering alcoholism, which reduced male life expectancy from the early 1970s. Characteristically, the Brezhnev regime responded with no concrete measures other than the suppression of the publication of these unfortunate statistics (Davis and Feshbach 1980). A popular anecdote described how different Soviet leaders reacted when their train stopped on the track. Stalin ordered the instant execution of the engineer, whereas Brezhnev just told his staff to draw the curtains and shake the train so that it felt like moving.

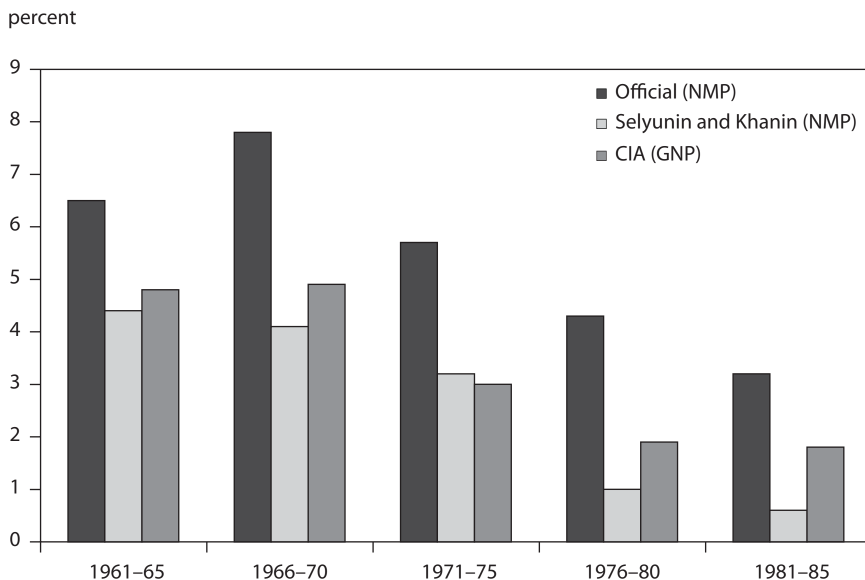
Brezhnev's Soviet Union was most successful in foreign policy. It caught up with the United States in the nuclear arms race, and the two superpowers sparred with one another across the world. As late as the 1980s, many Westerners foresaw a coming Soviet supremacy. The Soviet Union had 30,000 nuclear warheads and 5 million men under arms. It had deployed potent intermediary SS-20 nuclear missiles in Eastern Europe. The North Atlantic Treaty Organization (NATO) was trying to catch up by deploying American Pershing missiles to defend Europe from that threat, but this prompted massive peace demonstrations in Western Europe.

Already in control of Eastern Europe, the Soviet Union expanded its grasp to faraway places such as Ethiopia, Angola, and Mozambique. In December 1979, the Soviet Union invaded Afghanistan with a limited number of troops, but it overreached. The Soviet armed forces became bogged down in a deleterious and unwinnable war.

The popular attraction of Marxism-Leninism as an ideology, however, had ceased. The Soviet Union could no longer appeal to the world with its values, but these insights were barely known to the Soviet leaders because of the tight censorship. The flourishing of reform communism during the Prague spring of 1968 was the last time serious intellectuals believed that communism could be reformed and assume a human face. The impending death of communism became evident with the spontaneous eruption of the independent Solidarity trade union in Poland in August

Peterson Institute for International Economics | www.petersoninstitute.org

Figure 1.1 Soviet economic growth rate, 1961–85
(average annual growth in percent, comparable prices)



NMP = net material product
GNP = gross national product

Sources: Goskomstat SSSR (1986, 38; 1990, 9); Selyunin and Khanin (1987, 194–95); CIA (1990, 64).

1980. In reality, it was a democratic national front, which was so strong that it persisted for 16 months until Poland's president, General Wojciech Jaruzelski, declared martial law in December 1981.

The Soviet Union's crucial contradiction was that its economic growth was insufficient to guarantee the country's future military might. Officially, the Soviet economic growth rate was 3.2 percent a year in the first half of the 1980s, which corresponded to the annual increase in arms expenditure. The Western mainstream analysis concurred. The baseline projection of a major American study published in 1983, *The Soviet Economy: Toward the Year 2000*, which involved the greatest names in the American study of Soviet economics, forecast a Soviet GNP growth at 3.2 percent a year for the last two decades of the 20th century (Bergson and Levine 1983). Its greatest worry was that the growth of per capita consumption could fall below 1 percent a year, which could arouse a "crisis scenario" (p. 21).

But reality was worse. The two iconoclastic economists Vasili Selyunin and Grigori Khanin (1987) calculated that in the first half of the 1980s Soviet real growth was merely 0.6 percent a year—that is, stagnation (figure 1.1). Prime Minister Nikolai I. Ryzhkov (1992, 42) shared this percep-

Peterson Institute for International Economics | www.petersoninstitute.org

tion: "The situation in the country was straightforward frightening. The last years of 'Brezhnevshchina' left us with a heavy inheritance. . . . In 1982, the real incomes of the population did not grow—for the first time after the war!"

In reality, the Soviet Union appears to have entered complete economic stagnation by 1979. The country was still a superpower, but the military expenditures rose at the cost of everything else. The US Central Intelligence Agency (CIA) assessment was that Soviet military expenditures increased steadily by 3 percent a year, and the CIA gradually raised its estimate of the military share of Soviet GNP to 15–17 percent in 1987. But as the CIA overestimated Soviet GNP, a share close to 25 percent of GNP was more likely (Åslund 1990, Bergson 1997, Berkowitz et al. 1993). US defense expenditures, by contrast, stopped at 6 percent of GDP during President Ronald Reagan's rapid arms buildup.

Not all Western Sovietologists agreed with the mainstream. Brzezinski (1983) realized that the Soviet Union was a Third World country, which was obvious to all foreigners who lived there. In 1976, the US administration formed a "Team B" that challenged the conventional wisdom of the CIA. It argued that the Soviet economy was smaller and the defense burden greater (Pipes 2003, 132–43).

One of its members was Richard Pipes, the outstanding historian of Russia. After a stint in Reagan's White House, he published a forceful article in *Foreign Affairs* in 1984, which argued that the "communist societies, the Soviet Union included . . . are in the throes of a serious systemic crisis which sooner or later will require action of a decisive kind. . . ." Both the political and economic crisis "arise from a growing discrepancy between the responsibilities assumed by the communist elites at home and abroad, and the human and material resources with which to carry them out" (Pipes 1984, 49). "A crisis of such dimensions, camouflaged by massive disinformation and saber-rattling, fits very well the concept of a 'revolutionary situation' as defined by Lenin. The term meant to him a condition of stalemate between the ruling elite of a country and its population: the former could no longer rule, and the latter would no longer let themselves be ruled in the old way" (pp. 50–51). Pipes noticed the "universal disillusionment with political violence in the Soviet Union" and precluded the risk of restoration of Stalinism.

Pipes concluded that the country was likely to reform: "A Soviet Union that will turn its energies inward will of necessity become less militaristic and expansionist." Furthermore, "the greater the pressures on the Soviet regime to deal with genuine crises at home instead of artificially created crises abroad, the greater its dependence on its citizens, and the greater in consequence the ability of these citizens to deflect their governments from foreign adventures" (Pipes 1984, 60). Richard Pipes' foresight was close to perfect, and his analysis shows that Russia was no enigma. On this advice, Reagan embraced the Strategic Defense Initiative (SDI), known as "star

Peterson Institute for International Economics | www.petersoninstitute.org

wars," a high-tech defense against nuclear missiles that would numb the Soviet nuclear force.

The high-tech arms race was escalating, and personal computers were spreading across the world, but the Soviet Union resisted them because of technological conservatism, trade protectionism, and, most of all, a fear of free information flows. For the same reason, photocopiers were strictly forbidden in the Soviet Union. Excluded from the mounting information technology revolution, Soviet society became ever more backward.

The new guard in the Communist Party, and their outstanding leader Mikhail Gorbachev, saw this new reality. As second secretary of the CPSU, Gorbachev made a great programmatic speech in December 1984. Focusing on the critical nexus of the arms race, insufficient economic growth, and technological backwardness, Gorbachev (1987a, 86) formulated his goal to modernize and reinforce the Soviet economy to catch up with the United States in the arms race: "Only an efficient, highly developed economy can reinforce [our] country's position on the international stage and allow it to enter the [next] millennium with dignity as a great and flourishing power."

Soon after he had become general secretary of the CPSU in March 1985, he elaborated further on this theme:

> The necessity of an acceleration of the social-economic development is also dictated by serious external circumstances. The country has been forced to devote considerable means to defense . . . facing the aggressive policy and threat of imperialism, it is necessary to strengthen the defense power of the Motherland persistently and not allow military superiority over us. (Gorbachev 1985, 5)

By 1987, Gorbachev had abandoned the military theme, apparently having become aware of how serious the Soviet backwardness was. As a consequence, he focused on growth, efficiency, quality, and innovation, with the industrialized West as his unstated standard.

> The economic growth rates fell to a level that was actually approaching economic stagnation. We started evidently falling behind in one way after the other. The gap in efficiency of production, quality of products and scientific-technical progress began to widen in relation to the most developed countries, and not to our benefit. (*Pravda,* June 26, 1987)

An underlying reason for the course of Soviet development was the fortunes of the country's oil and natural gas production (Gaidar 2006). In the 1970s, the Soviet Union had developed huge new findings of oil and natural gas in Western Siberia, which were accessed through monumental new pipelines to Europe. In 1973, the first oil crisis struck. Energy prices skyrocketed and stayed high until 1981, granting the Soviet Union enormous windfall profits. The Soviet leaders directed this wealth primarily to military expenditures. Because of this apparent abundance of money, they did nothing to improve the economic system in the 1970s. In the late

Peterson Institute for International Economics | www.petersoninstitute.org

1980s, oil and natural gas production approached a peak with the available Soviet technology, and prices had fallen. To the Soviet public, the financial impact of the energy markets on the country's economy was not known, because international financial transactions were deeply guarded state secrets. Yet, the state finances were no longer tenable. Something had to give.

Mikhail Gorbachev and the Outstanding Provincials

In his essay *Will the Soviet Union Survive until 1984?* dissident Andrei Amalrik argued that the negative selection of leaders that was so striking under Brezhnev would cause the Soviet Union's collapse. To a considerable extent he turned out to be right, though the quality of the new leaders was surprisingly impressive.[2]

In 1980, the all-powerful CPSU Politburo was profoundly divided. The old Brezhnev loyalists were content with the situation and wanted no change whatsoever. Some of them were conspicuously corrupt, others simply conservative. Their adversaries were a mixed bunch. Their only common denominator was that they thought the Soviet Union could do better. Therefore, they desired change. These ambitious and restless men were initially led by Yuri Andropov and later by Mikhail Gorbachev.

By the time Brezhnev finally died in November 1982, he had been incapacitated by illness for much of the time since 1974. The background of his successor as general secretary, Andropov, was rather frightful. As ambassador to Hungary, he had overseen the bloody Soviet invasion of Hungary in 1956. For 15 years, he had chaired the feared Committee on State Security (KGB) when its techniques of repression had been perfected. He wanted to revitalize the Soviet economy through stricter discipline, and he aroused expectations of change.

Andropov started a febrile search for more dynamic cadres. He appointed whomever he could find to the higher ranks of the party to energize the country, drawing on an array of ambitious and frustrated provincial officials. Foremost among them was Gorbachev, who had already been a secretary of the Central Committee since 1978 and a full member of the Politburo since 1980, but Gorbachev had spent 23 long years rising in the party organization in his desolate home region of Stavropol in southern Russia.

Another Andropov favorite was Ryzhkov, who became Central Committee secretary for economic affairs in November 1982. He had spent 25 years in an engineering career largely in one company in his hometown of Sverdlovsk (today Yekaterinburg) in the Urals until he advanced to be-

2. This section draws primarily on Åslund (1991) and Brown (1996).

Peterson Institute for International Economics | www.petersoninstitute.org

come deputy minister of heavy machine-building in 1975 and then deputy chairman of the State Planning Committee (Gosplan).

A third Andropov appointee was Yegor K. Ligachev, whom Andropov made Central Committee secretary for personnel in December 1983. Ligachev came from Tomsk in Siberia, where he had been regional first party secretary for 18 years, bitterly regretting that he was not promoted to a senior party job in Moscow (Ligachev 1993, 50).

Andropov sacked corrupt, lazy, alcoholic, and overaged officials and replaced them with accomplished middle-aged men. He issued a decree on "the strengthening of socialist work discipline" and arrested some top officials for corruption. Conspicuous raids were undertaken against Moscow bath houses, where officials frolicked during working hours. Economists from the Soviet Academy of Sciences were discreetly asked about the country's economic problems. Minor economic "experiments" were attempted adjusting managers' incentives and the wage system. In spite of some new vibrancy, little was accomplished, because after a few months in office Andropov became fatally ill.

Andropov was succeeded as general secretary by Konstantin Chernenko, who had been Brezhnev's closest collaborator. He was a humble man who had much to be humble about. He had never been particularly dynamic, and he was seriously ill from the beginning. Literally nothing was done. Ligachev (1993, 34, 36) called Chernenko a "virtuoso apparatchik," inclined to "office work and papers, and [with] scant knowledge of real life." The Andropov triumvirate of Gorbachev, Ryzhkov, and Ligachev survived. Gorbachev replaced Chernenko as second secretary and chaired the important Central Committee Secretariat, which prepared all matters for the Politburo, and he even presided in the Politburo during Chernenko's long illness.

When Chernenko died after just 13 months in office, Gorbachev was elected general secretary the next day, on March 11, 1985. All top party officials who wanted change supported Gorbachev and they advanced swiftly. Ryzhkov became prime minister, and Ligachev replaced Gorbachev as second secretary. These three men formed a new ruling triumvirate. Personnel changes were quick and deep. Soon the entire aging leadership had been replaced by men mostly in their mid-50s, and these new managers pursued a similar revitalization of the whole Soviet administration. One of the first Gorbachev appointees was the first party secretary of Georgia, Eduard A. Shevardnadze, who became minister of foreign affairs in July 1985. The first party secretary of the Sverdlovsk region, Boris N. Yeltsin, was promoted to first party secretary of Moscow in December 1985.

These five new leaders—Gorbachev, Ryzhkov, Ligachev, Shevardnadze, and Yeltsin—had much in common. For better or worse, they were outstanding provincials. At a time of cynicism, corruption, and passivity, they were earnest and ambitious. They wanted to improve their country. None of them had benefited from a privileged background. They were all

Peterson Institute for International Economics | www.petersoninstitute.org

self-made men who had made their careers thanks to intelligence and hard work. Their rise bore witness to the openness of Soviet society, where such able men could enter the best schools and make high-flying party careers, as long as they accepted being obedient communists.

These men were the best and the brightest of the Brezhnev administration, but they also shared its weaknesses. Each of them had spent almost his entire life in his home region, apart from one or two spells of a few years in Moscow. As a result, they were quite ignorant about their own country. None of them spoke any foreign language, and they had only been abroad for several weeks as part of some circumscribed party delegation. They were excluded from the international policy debate and knew little about international economics or politics. Everything was presented to them through the rose-tinted glasses of Soviet propaganda.

To make their careers in the Soviet hierarchy, they were compelled to act as servile sycophants and compromise with the unacceptable. Few elites have been more poorly trained for major changes. In his memoirs, Ryzhkov (1992, 37) candidly reveals his own inadequate training, when Andropov offered him the job of Central Committee secretary: "I am a producer and not a party functionary. I toiled for 25 years at a factory, and three years in the Ministry of Heavy Machine-Building . . . then Gosplan. . . . I have no experience whatsoever of party work."

The economic and international ignorance reflected in the memoirs of both Ryzhkov and Ligachev is moving. In the midst of economic collapse in 1991, Ligachev (1993, 64) saw all the supply problems as being caused by political demonstrations that pulled people away from the potato harvest: "If everyone had cooperated in bringing in the harvest, they would have been torn away from all those senseless demonstrations and returned to real life. . . . In Western countries, when the weather is poor, the army helps farmers with the potato harvest." The parochialism of these able men must not be underrated.

The pretendents were frustrated at having waited so long for promotion. In his memoirs, Yeltsin (1990) details how at every turn he was promoted neither early enough nor high enough. Ligachev concurred:

> During the entire Brezhnev period, for the seventeen years that I had worked as first secretary of the Tomsk Province Party Committee, I had not managed to speak a single time at the Central Committee plenums. In the early years I regularly signed up on the speakers' list, but in time my hopes waned. . . . [W]hen Andropov became General Secretary, I, like many other provincial Party secretaries, was impatient for change, uncomfortably aware that the country was headed for social and economic disaster. (Ligachev 1993, 16)

One man in the new leadership, however, was very different and far more qualified: Aleksandr N. Yakovlev. He was the ultimate Moscow insider. From 1952 to 1972 he worked in the International Department of the Central Committee apparatus. He learned English and attended Columbia

Peterson Institute for International Economics | www.petersoninstitute.org

University in New York in 1959. In 1972, he published an article, "On Anti-Historicism," frontally attacking Russian nationalism, labeling it "patriarchal mentality, nationalism, and chauvinism." Not surprisingly, this brave act led to his ouster, but as a senior party official he was exiled to Canada as ambassador for 11 years, where Gorbachev detected him during a visit in 1983.

Ligachev (1993, 94, 108), who was seen as the toughest apparatchik and Yakovlev's foremost rival, called Yakovlev "one of the most experienced apparatchiks in the Central Committee. . . . [He has] the gift of persuasion and follows the thread of conversation with precise logic." While the calculating Yakovlev replaced newspaper editors, "we had no idea what a powerful and dangerous weapon the media could be in glasnost and pluralism. Alexander Yakovlev, who had spent many years in the West, naturally had a much better understanding of this than the other members of the Politburo . . ." (p. 105). Not by chance, Yakovlev, who was both an apparatchik and intellectual of world class, became the chief ideologist of perestroika.

All the new leaders realized that the Soviet Union was in bad shape and had to improve in many ways, but, with the possible exception of Yakovlev, they presumed that all solutions had to be socialist. The shock they were to face was that Soviet socialism was no solution but a dead end: Soviet communism could not be reformed, only destroyed. But if they had understood that, they would never have reached their high posts and might never have started to reform communism.

In due time, they would part company. By 1990, Ligachev and Ryzhkov had reverted to Brezhnevian conservatism, whereas Yeltsin and Yakovlev marched on to a liberal market economy and democracy. Only Gorbachev preserved his belief that Soviet communism could be reformed.

Early Perestroika: Cautious Economic Reforms to Boost Growth

In 1985, the new Soviet leaders were united in their desire to revitalize the Soviet economy and society.[3] Gorbachev and Shevardnadze reported that they met in the southern resort of Pitsunda in December 1984 and agreed: "We can't go on living like this" (Brown 1996, 81).

Against these "young" radicals aged 54 to 62 stood the Brezhnevian septuagenarians, who favored total passivity in economic policy and firm repression in domestic politics. After the Soviet invasion of Czechoslovakia in 1968, theirs had been a conservative, do-nothing government. Few of them were guided by any ideological conviction. In hindsight, they were

3. This section draws on Åslund (1991).

Peterson Institute for International Economics | www.petersoninstitute.org

more prescient than it seemed at the time, thinking that a major change would be dangerous.

Economic policy dominated the early stage of perestroika. As Gorbachev and his allies came to power, a new five-year plan for 1986–90 was being prepared, and they tried to make their imprint on this important policy document.

Three Different Programs of Perestroika

The incoming Soviet leaders were unified in their desire for rapid change, but they had very different ideas about what to do. Although they all favored common sense, their perception of common sense varied greatly, constrained as they were by ideological blinkers and parochialism.

A first group led by Ligachev advocated socialist morality, wanting little but the reinforcement of communist discipline. A second group led by Ryzhkov opted for technocratic improvements within the Soviet system. The most daring program advocated a socialist market economy, as was already in place in Hungary and Poland, with elements of private enterprise. This approach had no full-fledged advocate in the Politburo, but Gorbachev lent it partial support.

Ligachev (1989, 95) was not too unhappy: "We have no crises or unemployment, poor or homeless, no exploitation of the working masses. We are not suppressing other nations. In our country, the national repression has been liquidated." Ligachev (1985, 92) used terms such as "norms of socialist morals." He wanted in "every conceivable way to confirm the authority of honest and conscientious labor." He was a puritan who saw consumerism as the main evil, and he called for "vigilance in the struggle with bourgeois influences alien to our ideology and morals" (Ligachev 1985, 85–86). As early as June 1985, Gorbachev and Ligachev publicly expressed widely differing views. Slyly, Ligachev diffused Gorbachev's terms by altering them slightly. In his memoirs, however, Ligachev (1993, 97) alleged that they started parting company only in 1987.

Ryzhkov (1992) was a soft-spoken man with technocratic perspectives. I once sat diagonally across the table from him at a dinner in the Kremlin, and I was struck by his gentle manner. Ryzhkov (1992, 171) reported that at the beginning of perestroika: "I and my protagonists wanted only one thing: to stop the decline, to use all means and measures to move the economy forward." He aspired to improve organization and incentives and to decentralize management from the center to large regional units, while reducing the role of the party. One of his main preoccupations was the Law on State Enterprises, which would "precisely determine the rights and duties of enterprises and their place in the economic system" (p. 165). He favored a market economy for developed countries, but not for the Soviet Union. Its prices had to be regulated, while their regulation should improve. He ad-

Peterson Institute for International Economics | www.petersoninstitute.org

vocated greater tolerance and pragmatism: "Where power lies in the hands of *one* ideology, there is no place for different thoughts" (p. 84), but even so he insisted on the rule of the CPSU. It is easy to feel sympathy for Ryzhkov and his apparent honesty, but his astounding lack of economic insight made him lead the Soviet economy into its abyss (Yasin 2002, 118–21).

Yakovlev was the most radical member of the Politburo, but as a political scientist and historian he did not focus on the economy but democracy. When asked whether a full plan for reforms existed in 1985, he answered: "There was an understanding of what had to be rejected—authoritarianism and the command-administrative system. There was an urgent need for democracy, but we had to find out by what means and in what forms" (Yakovlev 1991, 33–34). Yakovlev gathered true democrats who desired a normal market economy with free prices and trade as well as predominant private ownership. But it took some time before they dared to utter such words, and no economist of market economic inclinations was a major economic policymaker until 1991. The leading economic reformers in the early perestroika were academic economists of Gorbachev's generation, primarily Academicians Abel Aganbegyan and Leonid Abalkin.

Initially, Gorbachev advocated the most radical reform program. Until November 1987, he was never outflanked by radicals, but he was an ideal compromiser who acted as a catch-all. True, he made the most radical statements first, but he also agreed to many measures that did not pertain to the radical agenda. Gorbachev revealed his reform agenda in his major ideological speech on December 10, 1984, three months before his elevation to general secretary of the CPSU. He referred to all three alternative reform programs and used most of his later famous slogans. He called moderately for the "acceleration of social-economic progress," "a deep transformation of the economy and the whole system of social relations," and "perestroika of economic management." But he also called for "revolutionary decisions," "competition" (without the compulsory attribute "socialist"), "self-management," "self-government," "glasnost" ("openness"), and even "democratization." Wisely, he avoided being specific (Gorbachev 1987a, 75–108).

At the 27th Party Congress of the CPSU in February 1986, Gorbachev for the first time called for "a radical economic reform." He had a clear idea of the direction of his political and economic strategy, but he also cleverly appealed to a broad coalition of all those who wanted any kind of change. Therefore, his reform attempts were never consistent. In July 1986, he stunned everybody by stating: "I would equate the word perestroika with revolution."[4] If only he had known how right he was.

Gorbachev was elected general secretary against strong resistance from the old Brezhnevites, who constituted half the Politburo, and his own coalition for change was riddled with divisions. Even so, he started out

4. *Pravda,* August 2, 1986.

Peterson Institute for International Economics | www.petersoninstitute.org

fast and hard. His early reform efforts amounted to an attempt to carry out all three reform programs with great energy, however contradictory they may have been. As none of the reform measures brought about any positive change, the literature tends to ignore them. Yet they were important because they set the course. The policymaking activity was impressive, and this wild trial-and-error period taught the new Soviet leaders how difficult the situation was.

Futile Technocratic Attempts at Accelerated Economic Growth

The new leaders all agreed on many technocratic improvements of the Soviet economic system, derived from Ryzhkov's program. They included higher growth targets, change of investment policy, and improved wage policy and quality control. Waste and misallocation were so widespread that they reckoned improvement would be easy.

One of Gorbachev's early slogans was "acceleration" of economic growth, which he wanted to boost from about 3 percent a year to at least 4 percent (Gorbachev 1987a, 214). However, if the real growth was close to stagnation, as Selyunin and Khanin (1987) argued, 4 percent was a distant target. Another early focus was investment policy. Gorbachev sent back the draft 12th Five-Year Plan for 1986–90 three times, demanding higher growth and investment targets. Although the new leaders talked about the need for a higher standard of living, they preferred to raise the accumulation in national income substantially from 25 percent in 1985 to 27.6 percent in 1990 (Faltsman 1987, 12), glossing over the conflict between increasing investment and consumption, and unpublished defense expenditures were also supposed to rise.

The late Brezhnev administration had concentrated on major "complex" programs, such as the Food Program (1982) and the Energy Program (1982), which set policies and directed investment to these industries. The early perestroika reinforced this focus on branch planning. Several new programs were adopted, a Consumer Goods and Services Program (1985), Chemicals Program (1985), and Machine-Building Program (1986), which led to huge, inefficient overinvestment. Soviet managers had strong incentives to start new investment projects to attract state funds, but not to complete them, because then their funds were cut. Many investment projects lasted for a decade or two. The number of investment projects ought to be cut, the managers' incentives preserved the long-lasting construction projects (*dolgostroii*).

The new leaders emphasized the importance of the "human factor." They ended the gerontocracy through sweeping personnel changes, but the old Soviet remuneration system impeded any positive impact from this well-intended housecleaning. For three decades, income differentials had continually shrunk, and the rewards for qualifications had declined

Peterson Institute for International Economics | www.petersoninstitute.org

so that unqualified blue-collar workers were paid more than engineers and physicians. The new rulers wanted to raise the salaries of the intelligentsia to stimulate people to enhance their qualifications as well as relate wages to final results of work, but a command economy possessed no relevant measure of final results.

The quality of Soviet output was miserable and declining. The Brezhnev regime had preferred carrots to sticks, and bureaucracy to markets, offering bonuses to producers who improved quality. But producers judged the quality themselves, naturally always sufficiently satisfied to receive their bonuses. Only military quality control was independent of producers. In late 1986, the Soviet authorities decided to create an independent inspection for state quality control (*gospriemka*), with highly qualified inspectors of great integrity and high pay. The new quality controllers did act severely, but their impact disrupted output volumes dramatically.[5] This decline in production, and related bonuses, was more than the system could tolerate. Although *gospriemka* was the main economic theme in Soviet media from November 1986 until March 1987, this fierce campaign fizzled within a couple of months.

Disciplinary Campaigns Against Alcohol and Private Incomes

Most damaging in the early perestroika were two old-style disciplinary campaigns, one against alcohol and another against private or "unearned" incomes. Both were throwbacks to Stalinist attitudes spearheaded by Gorbachev and Ligachev, while technocratic reformers, such as Ryzhkov, opposed them from the beginning.

Gorbachev unleashed the anti-alcohol campaign in May 1985.[6] Alcoholism was Russia's greatest social concern, and Russian women welcomed this campaign, but the philosophy of this campaign was entirely administrative—to reduce the production of alcohol and make it difficult to buy. It was not sustainable and was probably a cause of the later drop in life expectancy. The number of shops and licensed restaurants selling alcohol was reduced to less than half. Astoundingly, the number of licensed restaurants in Moscow, a city of 10 million people, was slashed to 87. Public sales of alcohol fell by more than half from 1984 to 1987, and production was cut by half. Prices were hiked, although not all that much, and enormous lines for alcohol arose. Vodka lines were easily identified because they were populated by men, whereas other queues were the preserve of women. This was a full-fledged disciplinary campaign of Stalinist

5. The substandard civilian machine-building sector experienced a drop in output of 7.9 percent in January 1987. *Ekonomicheskaya gazeta,* no. 8, 1987.

6. This section draws on White (1996) and Åslund (1991, 78–80, 158–63).

Peterson Institute for International Economics | www.petersoninstitute.org

vintage, staged with impressive stamina, though punishments were limited to fines and dismissals.

When visiting Soviet ministries before the campaign, I was usually offered cognac from 10 a.m. A visiting foreigner was a good excuse to begin drinking. Initially, the anti-alcohol campaign had a tremendous positive impact, as alcohol-related diseases, crimes, and accidents plummeted. The death rate and infant mortality declined, and life expectancy for men rose by two years. You would no longer see unconscious, dead-drunk men lying in the streets. In the short term, the social impact was impressive. Women were happy, but men were furious.

The economic impact, by contrast, was disastrous. In 1984, alcohol sales had accounted for 17 percent of total retail sales. The halving of these sales left a big hole in total supplies, which boosted all shortages. Almost 90 percent of alcohol sales went to turnover taxes, so tax revenues plummeted. Mainly because of the anti-alcohol campaign, the Soviet budget deficit in 1986 more than doubled to 6 percent of GDP, never to be reined in again. But the Soviet leaders did not even consider the fiscal effects.

The initial positive social results were not sustainable. The shortage of alcohol bred a large underground economy with ballooning organized crime thriving on moonlighting, poisonous liquor, and black market trade. Alcohol poisoning became a mass killer. The initial improvements were set to turn into equally great deteriorations. Perhaps more than any other single measure, the anti-alcohol campaign hastened the economic collapse of the Soviet Union.

Having learned nothing and forgotten nothing, like the Bourbons, the CPSU in the summer of 1986 launched another vicious neo-Stalinist campaign targeting private incomes. The official target was "unearned incomes," which were never defined. The diffuseness of the target suited the control agencies, which could act at will, deciding whom to persecute. Fortunately, punishments were limited to confiscation and fines. In practice, this campaign was directed against small private earnings, primarily production sold through the collective farm markets.

Outrageously, this campaign concentrated on poor pensioners, who badly needed this income for their subsistence. It was replete with quotas for the planned number of culprits in each region. The media had already gained considerable freedom, and the public criticism of this campaign was devastating. An article titled "The Criminal Tomato" by Igor Gamayunov in *Literaturnaya gazeta* (August 12, 1987) reported how a local "commission for the struggle against negative phenomena" had ordered convicted hoodlums to carry out the lawless destruction of hundreds of greenhouses for tomatoes in the Volgograd region.

The direct effect of the campaign against "unearned incomes" was that private food supplies shrank and prices on the relatively free *kolkhoz* markets rose manifold. The campaign encouraged police to indulge in lawless racketeering against marginal private entrepreneurs. It contradicted early

Peterson Institute for International Economics | www.petersoninstitute.org

talk about the establishment of a rule of law, and it ran counter to Gorbachev's whole policy, whereas Ligachev praised it in every speech from the summer of 1986, lamenting "speculators." This campaign embodied Ligachev's urge for police activism and socialist morality, underlining the limitation of Gorbachev's power. It faded away in the second half of 1987.

Everything was wrong with these two neo-Stalinist campaigns. They were voluntaristic initiatives by two Politburo members who acted without prior analysis. Both campaigns were economically harmful, aggravating shortages. The anti-alcohol campaign seriously undermined the budget, whereas the campaign against unearned incomes reduced supply by scaring people away from private enterprise and fostering lawlessness by the authorities. To the Soviet public, these two campaigns were the dominant economic policies from 1985 to 1987, which badly undermined public confidence in Gorbachev, who was responsible for these government-made disasters.

Attempts to Improve the Economic System

The changes in economic policy and the disciplinary campaigns were launched swiftly and with great determination, but attempts at systemic reform were much more tentative. A dominant complaint was that enterprises had no "masters," and managers' incentives were flawed. Several experiments aiming at improving enterprise management were under way, and they led to the landmark Law on State Enterprises in 1997.

The main goal of the enterprise experiments was to make enterprises more independent through decentralization, to enhance managers' power at the expense of branch ministries, and to improve managers' incentives. The most radical experiments involved self-management with elected managers and work councils. In the 1960s, the experiments preceding economic reform undertaken by then-Premier Alexei Kosygin had engendered impressive results. They had been more radical than the reform itself, and had aroused a conservative reaction (Nove 1969, 1977).

Now the contrary was happening. The initial experiments were cautious and embraced by a reasonably broad political consensus, but their economic results were deplorable. Some of the more radical experiments, such as self-financing and profit sharing in small units, had an initial positive economic impact, but they were effectively resisted by branch ministries whose powers they reduced. As a result, they inspired radical criticism that called for more far-reaching changes, breeding a radical momentum in the public debate.

The pedagogic value of the experiments was considerable, promoting economic analysis and showing that limited changes were not enough. The experiments exposed the intrinsic shortcomings of the command economy. Enterprise management could not be improved in isolation; arbitrarily set

Peterson Institute for International Economics | www.petersoninstitute.org

prices distorted all incentives; shortages of supplies emasculated attempts at cutting costs; no incentives could raise quality within the flawed system; the isolation from foreign markets nullified any interest in exports; and without any relevant objective function for enterprises, no remuneration system made sense. A political snowball effect was under way.

The technical complexity of many experiments necessitated economic analysis, which promoted economists within enterprises and in the national debate. Chief economists started replacing chief engineers as deputy directors at enterprises. A reformist vanguard was formed in the Central Committee apparatus, among academic economists and journalists. Managers made their careers on economic experiments and commissions for experiments established networks among reformers. But resistance was also consolidating in industrial ministries, Gosplan, Gossnab (the State Committee for Material and Technical Supplies), Goskomtsen (the State Price Committee), and the Ministry of Finance. The struggle between reformers and bureaucrats intensified.

The Emergence of Private Enterprise

Communism abhorred private enterprise.[7] The nationalization of the means of production was a fundamental tenet of communism, yet many problems in the Soviet economy could not possibly be solved within the public sector. Numerous goods and services were scarce, of substandard quality, or missing altogether. The black market filled the worst holes, but organized crime was not an acceptable solution. According to an official estimate, one-third of the demand for consumer services was satisfied by the public sector, another third by the unregistered private sector, and the remaining one-third was left unsatisfied. Private individuals could supply what was missing, but only if they were allowed.

Stalin had been determined to abolish private enterprise, chasing even artists into cooperatives, but minor remnants survived. The Soviet constitution of 1977 spelled out as permissible "individual labor activity in the sphere of handicrafts, agriculture, and consumer services for the population, as well as other types of activity, based exclusively on the personal labor of citizens and members of their families" (*Konstitutsiya* 1977, 9). In November 1986, 97,000 registered private entrepreneurs persisted, mostly odd arts and handicrafts. The most substantial private activity was 35 million private household plots, which accounted for 25 to 30 percent of all Soviet agricultural production. For many poor people, notably millions of old people without state pensions, these plots provided their subsistence. Some of the produce was sold on rather free collective farm markets. Surprisingly, 41 percent of the total housing area was private, essentially all the poor village housing and dachas. Besides, there were many cooperatives,

7. This section draws on Åslund (1991, 154–58).

Peterson Institute for International Economics | www.petersoninstitute.org

but only some of them were real cooperatives, notably cooperative housing, while cooperative farms or shops functioned like public enterprises.

The black market was very limited. Otherwise, shortages would not have been so cumbersome and prices on the black market so outrageous. A major study based on interviews with Soviet émigrés in the late 1970s estimated that 10 to 12 percent of total personal incomes, or 3 to 4 percent of GDP in the urban European part of the Soviet Union, originated from private activity, whether legal or illegal (Ofer and Vinokur 1992, 100). Even so, many Soviets were upset about black marketeering because marketeers were filthy rich in a country that was otherwise gray and egalitarian.

On November 19, 1986, the Law on Individual Labor Activity was adopted and it came into force in May 1987.[8] It legalized acceptable forms of individual labor activity. Economically, it was of minor significance, because the conditions offered were not very attractive. In 1989, only 300,000 people were registered as working in individual labor activity (Goskomstat SSSR 1990, 47).

Ideologically, however, this law was important and it contained several interesting innovations. One was that "other kinds of handicrafts are allowed, if their occupation is not forbidden in legislation." The Soviet standard until then had been that everything that was not explicitly allowed was prohibited. Surprisingly, planning and pricing were not even mentioned. This law initiated private enterprise, which was soon to rise with the support of six subsequent decrees on various kinds of independent cooperatives and individual farming adopted from October 1986 to October 1987. Each broke more ground for private enterprise, and the new cooperatives and individual labor were backed up by an impressive media campaign from the end of 1986.

Failure of Economic Reforms Breeds Radicalization

These many reform efforts were uncoordinated, lacking both theoretical and empirical basis. The top politicians made one impromptu decision after the other. After two years of intensive economic reform efforts, the conclusions were obvious. Small changes no longer contributed to economic improvements, but significant systemic changes were blocked or distorted by the all-powerful bureaucracy. A comprehensive reform was required, and it had to be market-oriented.

Gorbachev mastered these insights. In June 1987, he organized a Central Committee plenary meeting on economic reform to take the reforms further. Exasperated, he exclaimed, "we shall not succeed with the tasks of perestroika, if we do not firmly pursue democratization."[9] He con-

8. *Pravda,* November 21, 1986.

9. *Pravda,* June 26, 1987.

Peterson Institute for International Economics | www.petersoninstitute.org

cluded that the Soviet Union must proceed with more radical economic reform. He outlined a reform program that he summarized in five points:

1. the extension of enterprise independence with self-financing;
2. perestroika of centralized economic management;
3. a cardinal reform of planning, price formation, and the credit system as well as the introduction of wholesale trade;
4. a new organizational structure; and
5. transition from centralized command management to self-management.

All these ideas were incorporated in the Law on State Enterprises, which also comprised a general program for economic reform (chapter 2).

Glasnost: Shattering All Illusions

Today it is difficult to imagine how stereotypical and controlled the Soviet media were. Each evening, the TV news started with a review of the meetings of the top officials that day. Bizarrely, the news showed a blast furnace from a steel mill every evening, and in the summer, interested viewers could follow the harvest. Brezhnev mumbled out his long speeches, seemingly unaware of what he was reading. Once during a major speech, he read the same page twice. The people were fed a steady diet of supposed success stories. No bad news such as crime was allowed, although in their daily life people saw a gray, drab, stagnant world. Kremlinologists developed methodologies on how to interpret the communist liturgy and read between the lines. Soon after his election as general secretary of the CPSU, Gorbachev made these techniques superfluous. In 1985 it was difficult to find any information in Soviet media, but by 1989 media freedom was nearly complete, and the problem was to find out what was true.

In his December 1984 speech, Gorbachev introduced glasnost, which was his elastic code word for greater public openness. Like most of Gorbachev's key expressions, glasnost had no ideological connotation and its meaning was diffuse. It meant openness rather than freedom of speech. In May 1985, Gorbachev caused a first great shock, which marked the beginning of glasnost. During a visit to Leningrad, he mingled with a huge crowd and spoke without script in front of television cameras, a far cry from the traditional Soviet leaders' isolation from the people with strict, formal meetings and prepared speeches. Russians were stunned to see a leader who could walk and talk. The extraordinary Soviet censorship started to falter. In one step after the other, the many ideological taboos were broken.

Quaintly, most great revelations were published in the traditional thick, monthly literary journals, notably the liberal *Novy mir*. In many Russian

Peterson Institute for International Economics | www.petersoninstitute.org

homes, you still notice literary journals from the years 1986 to 1989. Those were the great years of glasnost. People learned things they had never expected to hear. Several Soviet friends told me that they would save these journals forever to remember that once their country had actually been so free.[10]

On April 26, 1986, one of the large nuclear reactors in Chernobyl, slightly north of Ukraine's capital Kiev, melted down, and substantial radiation was released into the atmosphere. Although glasnost was well under way, the Soviet authorities kept absolutely quiet, and the news was released by the Swedish authorities. As a Swedish diplomat working in Moscow, I asked a cabdriver a week after the accident if he knew about it and he did not. "They never tell us anything!" he exclaimed. That day, *Pravda* published a small notice on its second page that some accident had occurred at the Chernobyl nuclear power station, but only the elite accustomed to reading between the lines understood the gravity of these words. Skillfully, Gorbachev utilized this stunning underreporting by the old establishment to force greater public openness after Chernobyl.

In June 1987, the literary journal *Novy mir* published an article by the liberal economist Nikolai Shmelev called "Advances and Debts." It was a breathtaking attack on the Soviet economic system, debunking most Soviet economic taboos. Shmelev started his onslaught:

> The state of our economy does not satisfy anybody. Its two central, inbuilt defects, the producer's monopoly under the conditions of shortage and the enterprises' disinterest in scientific-technical progress, are probably clear to everybody. (Shmelev 1987, 142)

The economy bred pervasive shortages, was highly inefficient compared with Western economies, produced awful quality, and was unable to accept innovations. He also complained about *dolgostroii*, the long-lasting investment projects, expensive overinvestment, extraordinary hoarding of inputs, and all kinds of waste. All these problems of the Soviet economy were well known, but they had typically been presented as special cases, whereas Shmelev made clear they were innate to the Soviet economic system: "From the very beginning this whole system was characterized by economic romanticism, tightly linked to economic illiteracy." He dismissed central planning as anarchic: "Today we have a shortage [economy], unbalanced on virtually all accounts and in many ways unmanageable, and to be completely honest, an economy which almost does not yield to planning" (p. 144).

The Soviet system bred the very demoralization and alienation it was supposed to have abolished:

---

10. At the time of this writing in the summer of 2007, these statements seem to harbor even more foresight than they did at the time.

Peterson Institute for International Economics | www.petersoninstitute.org

Apathy and indifference have become mass phenomena as well as theft, disrespect of honest work and simultaneously an aggressive jealousy of those who earn a lot, even if they earn honestly. Signs have appeared of an almost physical degradation of a substantial part of the population because of drunkenness and idleness. (Shmelev 1987, 145)

Shmelev famously exclaimed: "Let us lose our ideological virginity." The main hindrance was "the worry that we let out the evil spirit of capitalism" (pp. 146–47). His key idea was that markets had to be balanced and that Russia must move from the seller's market to the buyer's market. But even Shmelev cited Lenin to defend his position. Although he obviously favored a market economy, his actual proposals were merely incremental steps. Perhaps most daringly, he advocated the acceptance of joint stock companies as a means to absorb the population's excess savings, and he thought enterprises should focus on profit and their physical plan targets be abolished. He also suggested that bad enterprises should be closed, workers disciplined through dismissal, and frictional unemployment be deemed acceptable.

This article reflected the contradiction between urgency and hesitation that would be so characteristic of the Russian reforms. On the one hand, Shmelev (1987, 142) warned of partial reforms as in 1953 and 1965 because "half-measures are often worse than passivity." On the other hand, he considered it unrealistic to expect rapid changes, as reforms would require years, perhaps generations.

For a month, Shmelev's article dominated conversation in Moscow. It became such an issue that Gorbachev expressed his public support, in effect allowing full-fledged attacks on central planning.[11] After the publication of this article, profound criticism of the socialist economic system and pure market economic thinking were permitted.

In its following issue, *Novy mir* published a letter with the title, "You Cannot Be a Little Pregnant." The letter was written under the pseudonym "L. Popkova" (1987) by Larisa Piyasheva, a neoliberal researcher specializing on Germany at an institute of the Academy of Sciences. She argued that it was not enough to adopt some capitalist features; a consistent capitalist system was needed.

Similar articles criticizing all aspects of Soviet society appeared one after the other, mostly written by liberal stars within the old intellectual establishment. At the height of glasnost, one anecdote reported on a man who phoned a friend:

"Have you read the article on the first page of *Pravda* today?"

"No, what does it say?"

"Sorry, I dare not tell you on the phone."

Nothing seemed too tragic to be expressed. Criticism of the Soviet system suited Gorbachev well, but after the flood gates had been opened its

11. *Pravda,* June 22, 1987.

Peterson Institute for International Economics | www.petersoninstitute.org

flows could not be contained, and the truths that were finally made public were truly shocking. Although all Soviet people know about many disasters, few knew all of them, and the bombardment of all these old truths was overwhelming.

The collectivization of agriculture in the 1930s, and the killings of millions in the process, could not be justified. In Ukraine as well as Kazakhstan, about a quarter of the population had been killed in an artificial famine imposed by secret police troops in connection with collectivization (Conquest 1986). The terror of 1937, which had killed about one million of the old Communist Party elite, was unforgivable. The three small Baltic nations had never wanted to join the Soviet Union, and their occupation was concluded in the infamous Molotov-Ribbentrop Pact with Nazi Germany in August 1939. According to *Encyclopaedia Britannica*, World War II population losses in the Baltic states amounted to 25 percent in Estonia, 30 percent in Latvia, and 15 percent in Lithuania, much of these coming from Soviet deportations. How could that ever become legitimate?

As the openness increased, previously suppressed acts and statements of brutality by Lenin, Gorbachev's remaining great hero, were made public. Lenin had indeed indulged in arbitrary terror and established the Gulag, the Soviet prison camp system. The Communist Party apologized for its repression of its own members in the 1930s but not much more.

Gorbachev's ultimate problem was that he was defending a regime and a history that nobody could defend. Until the end, he insisted that socialism and Lenin were good, which made no sense. He had no plausible narrative about Soviet history, and his only defense was obfuscation.

Even so, Gorbachev and his closest collaborator Yakovlev were the driving forces behind glasnost. In May–June 1989, virtually all communist taboos were broken and in practice the freedom of public expression was established. The revolutionizing event was the first session of the USSR Congress of People's Deputies. Its proceedings were directly broadcast on television and published in full in the main newspapers. Almost half the population watched these broadcasts as the most exciting soccer match. Everything could be said and it was said. The radicals might have dominated, but they encountered full-fledged resistance from Stalinists. The Soviet public's perception of their country changed forever.

New Thinking on Foreign Policy

One of Gorbachev's early slogans was "a new thinking in foreign policy." It was even more unclear than his other slogans—perestroika and glasnost—which was his intention. The 27th Party Congress in February 1986 adopted Gorbachev's "concept of a contradictory but interconnected, interdependent and, essentially, integral world" (Gorbachev 1987b, 139).

Peterson Institute for International Economics | www.petersoninstitute.org

His new foreign policy was verbose and full of platitudes, but it had several clear purposes. One was to diminish the cost of Soviet foreign policy. Most of all, Gorbachev wanted to impede the nuclear arms race with the United States because the USSR could no longer afford it. As Ligachev (1993, 329) put it:

> After April 1985 we faced the task of curtailing military spending. Without this, large-scale social programs could not have been implanted: the economy could not breathe normally with a military budget that comprised 18 percent of the national income.

Another aim was to end the war in Afghanistan, which was very unpopular, had cost many lives, and had brought about a serious social problem, as many war veterans came back as drug addicts and hardened criminals.

Gorbachev's foreign policy had domestic goals as well. He had little leeway in domestic politics, and like so many heads of state he used his foreign policy skills to enhance his authority domestically. By de-ideologizing foreign policy and trying to open his country to the outside world, Gorbachev undermined the grasp of sterile Marxism-Leninism in the Soviet Union.

In addition, as in all of Gorbachev's policies, he sought the unexpected and the unknown. Later on, he was to launch the concept of "the common European house," but he never managed to endow it with substance. Gorbachev just loved foreign policy. It offered him breathing space, delight, and unanticipated luck. While leading a Soviet delegation to Canada in the summer of 1983, he met Yakovlev. During his first high-profile trip to England in December 1984, Prime Minister Margaret Thatcher surprisingly and memorably declared: "I like Mr. Gorbachev. We can do business together" (Brown 1996, 77). He acquired the unique knack of letting his limousine halt unannounced to mingle with crowds during his foreign travel. He was soon mobbed like a rock star, being the greatest political celebrity in the world. In 1987, *Time* magazine named him the man of the year.

When Gorbachev came to power, Soviet foreign policy was in a deep freeze and the Cold War was at its last height. The country had been extremely closed all along, but Soviet relations with the West had been badly aggravated by three recent events. The first was the Soviet invasion of Afghanistan in December 1979, which appeared to be a Soviet attempt to widen its sphere of influence in the world. As a consequence, the United States boycotted the Olympic games in Moscow in 1980, and the Soviet Union retaliated by boycotting the Olympic games in Los Angeles in 1984.

The second event was the big Soviet-American dispute over intermediary nuclear forces. In 1977, the Soviet Union started installing new intermediary nuclear missiles (SS-20) in Eastern Europe, which enabled it to reach targets in Western Europe, North Africa, the Middle East, and a

Peterson Institute for International Economics | www.petersoninstitute.org

good part of Asia within a quarter of an hour (Goldblat 2002, 84). The West was particularly worried about the absence of a warning period. A Soviet surprise attack on Western Europe had become much more possible. In December 1979, NATO responded by preparing to deploy its own intermediary nuclear missiles (Pershing II) and the ground-launched Tomahawk cruise missiles in Germany and other European NATO members. A large left-wing peace movement in Europe protested against the plans to deploy Western missiles but not against the Soviet SS-20s, which were already in place. Despite this public outcry, in 1984, the United States began to put its intermediary nuclear missiles in West Germany, Italy, and the United Kingdom.

The third big event was the formation of the independent trade union Solidarity in Poland in August 1980. It was curtailed after only 16 months through the imposition of martial law by Poland's president, General Wojciech Jaruzelski, as demanded by the Soviet leadership. The Soviet view was that Solidarity was a Western subversive action.

Against this backdrop, the United States reinforced its long-lasting embargo on exports of technology to the Soviet bloc and opposed the building of the Urengoy-Uzhgorod natural gas pipeline from the newly developed gas fields in Western Siberia to Europe, primarily Germany. In spite of a US embargo against deliveries to the pipeline construction, the Europeans went ahead, which caused a major rift between America and Western Europe. The United States argued that European gas imports would strengthen the Soviets by increasing their hard currency earnings (thus financing the Soviet military effort) and weaken the allies by making them dangerously dependent on the Soviets. Despite severe US opposition, the pipeline was completed in 1983, and France, Austria, West Germany, and Italy received natural gas through it. The Kremlin was determined to show that Reagan's attempts to block construction of the pipeline through economic sanctions had been a failure, and they won. The US pipeline embargo, which created a political storm on both sides of the Atlantic, was eased at the end of 1982 (Jentleson 1986).

Arguably, in the early 1980s the relationship between the Soviet Union and the West was worse than at any time after the Cuban missile crisis in 1962. The last US-Soviet summit had taken place in 1979, when Leonid Brezhnev met Jimmy Carter in Vienna. They signed the Strategic Arms Limitation Talks Treaty (SALT II), which was supposed to limit the number of strategic offensive weapons systems, but it was never ratified and thus did not come into force. Neither Andropov nor Chernenko even contemplated a Soviet-American summit during their brief spells in power.

In the United States, Reagan was elected president in 1980 on an aggressive anti-Soviet platform, advocating extensive American nuclear armament and the SDI. In 1983, Reagan famously called the Soviet Union "the evil empire." The mutual confidence between the Soviet Union and the United States was close to zero, and accidents such as the 1983 Soviet

Peterson Institute for International Economics | www.petersoninstitute.org

shooting down of a South Korean passenger airplane that had inadvertently entered Soviet air space further aggravated these miserable relations. The danger of a nuclear war caused by misunderstanding had hardly ever been greater.

Resolutely, Gorbachev decided to change all this. His first opportunity was at the funeral of his predecessor Chernenko in March 1985. He saw an unprecedented number of foreign leaders, giving preference to Westerners. From the outset, Gorbachev traveled the world. His most important aim was to develop good relations with Reagan. A first summit between them took place on neutral ground in Geneva in November 1985, and they forged good personal relations. Gorbachev and Reagan issued a joint statement that "a nuclear war cannot be won and must never be fought."

From that time, Reagan-Gorbachev summits became regular events and quite a craze. The two leaders got along extremely well, and their aims were complementary. Reagan had pursued a tough arms buildup in order to win the arms race, and he took Gorbachev's desire for arms control as a sign of victory. Gorbachev, on the other hand, wanted to reduce the Soviet military's material demands, which an arms control agreement would give him.

The most important summit between Gorbachev and Reagan took place in Reykjavik, Iceland, on October 11–12, 1986. Gorbachev surprised everybody by proposing the elimination of all nuclear arms by 2000, and Reagan concurred. To the immense relief of Reagan's aides, the leaders did not conclude any agreement, but the ice was broken. The question was no longer whether the Soviet Union and the United States would make an agreement on nuclear arms control but the details.

Gorbachev's goal was to impose restraints on the American SDI, while Reagan was reluctant to compromise. He proposed reducing offensive capabilities by eliminating intermediary nuclear forces, while jointly building up a defensive system sharing the SDI technologies. Reagan's aim was to convince the Soviet Union of the mutual advantages of sharing the benefits of strategic defenses. Defense would dominate over offense, rendering nuclear weapons obsolete. But Gorbachev did not take the idea of shared SDI seriously, regarding it as an offensive technology. The Soviet leaders saw SDI as a means to force the Soviet Union to greater military expenditures, which was exactly what Gorbachev wanted to avoid (Matlock 2004).

The Reykjavik meeting fell apart over the issue of whether the Anti-Ballistic Missile Treaty (ABM) signed by the United States and the Soviet Union in 1972 permitted research, development, and testing of high-technology space-based defensive systems (as the United States argued) and over Gorbachev's attempt to confine the SDI program to "laboratory" research. Still, Reykjavik was one of the most remarkable summits ever held between US and Soviet leaders. US Ambassador to Moscow Jack

Peterson Institute for International Economics | www.petersoninstitute.org

Matlock (2004, 250) called Reykjavik a "psychological turning point." At the same time he concluded that "it was good that the meeting did not reach the understanding on arms reduction that Gorbachev had proposed and to which Reagan had come close to agreeing . . . because the agreements would not have worked" (p. 249).

The progress achieved in Reykjavik led to the signing of the bilateral Intermediate-Range Nuclear Forces (INF) Treaty between the United States and the Soviet Union in Washington on December 8, 1987. Matlock (2004, 271) calls the INF Treaty "the most significant step the United States and Soviet Union had ever taken to reverse the direction of the arms race." It provided for the complete elimination by the United States and the Soviet Union of intermediate-range missiles (ranges of 500 to 5,500 kilometers). The agreed reductions were asymmetrical: the destruction of 1,836 missiles on the Soviet side, but only 859 missiles on the US side (Goldblat 2002, 86). Both nations were allowed to inspect each other's military installations to ensure compliance. This breakthrough became possible after the INF agreement had been decoupled from the SDI; the Soviet Union initially had insisted on them being negotiated as a package. Another Soviet concession was that the treaty was confined to US and Soviet armaments only, ignoring British and French nuclear forces. The INF Treaty left both countries with large nuclear arsenals, but many weapons were destroyed and it was a precedent for further arms reductions.

Gorbachev's other big foreign policy task was to withdraw from Afghanistan. The Soviet Union did not need to agree with anybody, just withdraw. Gorbachev and Shevardnadze understood that this had to be done. As early as October 17, 1985, they received initial approval from the Politburo. In an attempt to secure an orderly retreat and the maintenance of a pro-Soviet government in Kabul, Gorbachev opted for an international agreement, the Geneva accord, on ending of the Soviet intervention in Afghanistan. It was signed on April 14, 1988 by Afghanistan, Pakistan, the United States, and the Soviet Union. The withdrawal of Soviet troops started in May 1988, and the last Soviet soldier departed in February 1989 (Brown 1996). A sad chapter of unprovoked and foolhardy expansionism had been closed.

Within three years, Gorbachev had achieved his three main foreign policy objectives. He had concluded a major arms control agreement with the United States that made it possible to reduce Soviet defense expenditures after 1988. The Soviet Union had ended its meaningless war in Afghanistan without any future commitments. And Gorbachev had greatly improved relations between the Soviet Union and the West. In addition, he was universally seen as the greatest international star in the world. The phrase "Gorbomania" was coined for good reasons. Arguably, Gorbachev's first three years of foreign policy were his greatest success in any sphere. He knew what he wanted and he achieved it.

Peterson Institute for International Economics | www.petersoninstitute.org

Why Gorbachev's Attempt at Chinese Reforms Failed

A huge literature has criticized the Soviet and later the Russian leadership for not having copied the Chinese economic reforms. Common complaints are that Russia did not experiment enough, had too fixed an idea of a Western market economy, did not start with agricultural reform, and privatized too fast.[12]

Let us compare the actual situations. The natural starting point for comparison is China in 1978 and the Soviet Union in 1985, when Deng Xiaoping and Gorbachev, respectively, initiated their reforms.[13] The differences in preconditions were substantial. They concerned politics, macroeconomics, and economic structure.

A fundamental difference between China and the Soviet Union was that China had just gone through the Cultural Revolution, which had terrorized the party bureaucrats, while the Soviet Union had indulged in two decades of Brezhnevism, which accommodated bureaucrats in every regard. In China, the apparatchiks were still on the defensive, which made it possible for Deng Xiaoping to impose reforms from above. In the Soviet Union, by contrast, the bureaucrats were supreme and accepted no undesirable changes.

In April 1985, one month after his accession to power, Gorbachev issued a decree on a minor agricultural reform. I paid a visit to Gennady Kulik, an old-style apparatchik and then head of the foreign relations department of the Soviet Ministry of Agriculture. When I asked what Gorbachev's decree really meant, he replied: "Not a thing! Why should I care about a decree signed by the general secretary of the Communist Party?!" I thought this was an old-timer on his way out, but Kulik went on to become minister of agriculture and deputy prime minister, so he was no fool but an accomplished bureaucratic player.

The decree implied some minor decentralization, which would have reduced the power of the Ministry of Agriculture, which thus refused to implement the decree. The agricultural bureaucracy knew it was unbeatable. Wisely, Gorbachev abandoned all attempts to reform agriculture until he reformed the ministry itself, but that did not help because the result was only bureaucratic chaos. In contrast to this overbearing agricultural bureaucracy, in China the initial reforms, which focused on agriculture, could introduce quasi property rights for those who worked the land.

Another Soviet political peculiarity was that the general secretary had very limited power within the Politburo. Gorbachev never managed to achieve a majority in the Politburo for his own cause. After he had defeated the old Brezhnevites, his own appointees, Ligachev and Yeltsin, turned against him from opposing sides. Toward the end, he became a hostage of

12. Goldman (1996, 2003); Nolan (1995); Stiglitz (1999a, 2002).

13. I elaborated on this topic in Åslund (1989).

Peterson Institute for International Economics | www.petersoninstitute.org

communist stalwarts. Gorbachev's strengths were compromise and manipulation, but his weak power, lack of firm principles, and the absence of consensus were disastrous for the consistency of the policy pursued.

It was not true that the Soviet leaders did not experiment. They experimented in the 1920s, 1950s, 1960s, and 1980s, and undertook far more experiments than the Chinese. The Soviet leaders were guided by pragmatism and common sense, exactly as the Chinese advocates of reform, but pragmatism was a major problem for the Soviets. Gradually realizing that much of Marxism-Leninism was bunk, the Soviet leaders were left empty-handed intellectually. They had no theory and no analytical framework. They were a crowd of the blind, being led by almost equally blind Soviet academicians who had not been allowed to travel abroad or study any of the foreign (capitalist) theories of the last few decades.[14] They were not even permitted to see real Soviet statistics. The early perestroika bears witness to the danger of economic experimentation without any theory.

To the Soviet people, the economic reforms in the 1920s, 1950s, and 1960s were dispiriting experiences. They knew that pioneers would be likely punished some day regardless of what the top politicians said today, so they were understandably reluctant to stick their necks out. Too many heads had been chopped off. Consequently, their response to Gorbachev's initial reform attempts was muted. The Chinese, by contrast, responded to reforms with an enthusiasm similar to that of the Soviet peoples in the 1920s, and they achieved early impressive results.

The Cultural Revolution had left China in serious economic and social discomfort, which rendered major changes necessary. In the Soviet Union of 1985, by contrast, there was no sense of crisis, but an overwhelming sense of constancy. Most Western analysts thought little would happen for decades (Bergson and Levine 1983). Few but Gorbachev and his allies could imagine that change was possible. At the time of Gorbachev's elevation to general secretary of the CPSU in March 1985, I asked several people in Moscow what had been the most important event that week. The dominant answer was that the cucumbers had arrived at the *kolkhoz* markets, so their price had fallen by half. No ordinary Soviet citizen could imagine that a new party leader could alter anything in their stagnant country.

Economically, the structural differences between the Soviet Union and China were large and significant (Sachs and Woo 1994). In the Soviet Union, industry accounted for about half of GDP in 1985, while three quarters of the Chinese worked in agriculture. And the early Gorbachev reforms caused no economic improvements, only aggravated shortages in 1978. Thus, in China, it was possible to omit industry in the early stages

14. When I met Abel Aganbegyan, the foremost Soviet reform economist, for the first time in 1988, he told me upfront that he had been prohibited from traveling to the West for ten years. Unlike most of the old academicians, Aganbegyan spoke English and he went on to become a true supporter of a free market economy.

Peterson Institute for International Economics | www.petersoninstitute.org

of reform, while that was impossible in the Soviet Union. Because Soviet industry was so dominant and powerful, it could be neither circumvented nor simply nudged along. The only viable options were frontal attack or compromises benefiting the captains of industry. Naturally, the old communist establishment preferred the latter option. With its limited state industry, China could bear the resulting costs, whereas in the Soviet Union those costs were overwhelming.

Another structural disparity was that Soviet enterprises were predominantly large-scale and mechanized, while China was dominated by manual labor. Any reform in the Soviet Union had to touch upon large enterprises. Even Soviet agriculture aimed at economies of scale, and a normal collective farm had some 5,000 hectares and matching equipment, because small firms and farms were perceived as backward in the Soviet Union.

While China's defense expenditures were high by international standards, those of the Soviet Union were outlandish. The Soviet Union had to try to reduce its defense outlays from about one-quarter of GDP to perhaps one-twentieth. This required both arms control agreements with the United States and withdrawal from Afghanistan, two major problems that absorbed much of the leaders' time. China had no corresponding concerns.

Macroeconomic policy varied greatly between the Soviet Union and China. Gorbachev allowed the previously small budget deficit to rise to 6 percent of GDP in 1986, and it only grew. By ignoring this deficit, Gorbachev guaranteed a future macroeconomic crisis with high inflation. Nobody who was anybody in the Soviet Union had a clue about macroeconomics. Not even the top Soviet academicians knew that a budget deficit could be damaging or that it needed to be financed. "Macroeconomics" was about as negative a word as "capitalism." Among the many senior officials Gorbachev appointed, none was younger than he, and no nonparty heretics were permitted, and of course no foreigners. China had not fallen as deep into the enforced economic ignorance of communism as the Soviet Union, presumably because its period of communist rule had been much shorter.

Unlike China, the Soviet Union was also hit by a major external shock. In China, the memory of hyperinflation in the 1940s was vivid, and macroeconomic conservativism prevailed. The Soviet Union had benefited from very high international oil prices throughout the 1970s, which had precluded reforms. In the 1980s, oil prices fell, reaching their lowest level in 1986, when Gorbachev launched perestroika, and they were to stay low for years. Together with the large budget deficit, the low oil prices undermined the Soviet Union's international finances, which drove the need for more radical reforms (Gaidar 2006). China was less dependent on commodity prices.

In the end, the situations in China and the Soviet Union differed in almost every political and economic regard. The problem was not that Gorbachev did not follow the Chinese lead but rather that he followed it too closely under very different circumstances. Both countries experimented,

Peterson Institute for International Economics | www.petersoninstitute.org

but the Soviet Union suffered more from the lack of economic theory. The Chinese were sufficiently aware of public finances to avoid any financial crisis, while the Soviet leaders were profoundly ignorant and brought their country to the verge of the abyss of hyperinflation. In China, central power was sufficient, which was not the case in the Soviet Union. The Chinese experienced a profound sense of crisis after the Cultural Revolution, while the dominant Soviet view after the Brezhnev period was that change was not only wrong but impossible. The Soviet bureaucracy was strong and adamantly opposed to reform, while the Chinese bureaucracy was relatively smaller and softened by the Cultural Revolution. The Soviet people had seen too many reforms to react positively, whereas the Chinese embraced reform enthusiastically. The large-scale and overindustrialized Soviet Union could not avoid reforming large industrial companies, while those companies were marginal in China and could be omitted from reform. When international oil prices fell, the Soviet Union had little choice but to reform. As a consequence of these preconditions, Soviet communism proved unreformable, while the predicament of Chinese communism goes beyond this study.

An Untenable Mix of Changes

The sudden burst of activity in the Soviet Union over 1985–87 broke two decades of petrification. The reform started from the top, which was the only possibility, with a sweeping change of leaders. Gorbachev and his colleagues concentrated on three major policies during their first three years in power: economic perestroika, new thinking in foreign policy, and glasnost, with remarkably different outcomes.

From the outset, the Gorbachev team's top priority was to revitalize the economy. Eclectically, they tried all kinds of measures with great energy, but they invariably failed. No positive impetus was added to economic growth. Shortages were greatly aggravated because tax revenues declined with the anti-alcohol campaign, and a larger share of GDP was diverted to inefficient investment. Meanwhile the campaign against "unearned incomes" reduced private food supplies. Perestroika fell miserably short of its main goal to boost economic growth. Official growth lingered at 2–3 percent a year, which probably meant actual stagnation.

Gorbachev took everybody by storm with his new thinking on foreign policy and his success in containing the arms race through arms control agreements with the United States. The Politburo also decided that the Soviet Union had to leave Afghanistan. Rather than increasing the resources available for Soviet armaments, Gorbachev cleverly reduced the need for more armaments. Soviet relations with the West swung from a low to an all-time high. Quite unexpectedly, his foreign policy stood out as a resounding success in the early perestroika.

Peterson Institute for International Economics | www.petersoninstitute.org

Glasnost took off later than the other policies and much more gradually. It came into its own in 1987 and freedom of speech was attained in 1989. Gorbachev unleashed glasnost in order to undermine hard-line communist opposition to his reforms, but glasnost turned into an unguided missile. It condemned not only dogmatism and bureaucracy, but the very foundation of the Soviet state and especially its ruthless policies against various nationalities. Rather than strengthening the Soviet state, glasnost eventually suggested that it was not viable.

Peterson Institute for International Economics | www.petersoninstitute.org