

**19565**

February 1992

**SOCIALIST ECONOMIES REFORM UNIT  
COUNTRY ECONOMICS DEPARTMENT  
WORLD BANK**

**COLLOQUIUM ON THE  
FORMER SOVIET UNION  
FOR THE  
EXECUTIVE DIRECTORS  
OF THE  
WORLD BANK**

**WESTFIELDS INTERNATIONAL  
CONFERENCE CENTER  
CHANTILLY, VIRGINIA  
FEBRUARY 27 - 28, 1992**

**FILE COPY**



# COLLOQUIUM ON THE FORMER SOVIET UNION FOR THE EXECUTIVE DIRECTORS OF THE WORLD BANK

SOCIALIST ECONOMIES REFORM UNIT  
COUNTRY ECONOMICS DEPARTMENT  
FEBRUARY 27-28, 1992

## TABLE OF CONTENTS

Agenda	
I.	Summary of Main Points . . . . . i
II.	Presentations
	Lawrence H. Summers . . . . . 1
	Strobe Talbott . . . . . 6
	Anders Aslund . . . . . 10
	Abel Gezevich Aganbegyan . . . . . 14
	George Soros . . . . . 17
	Norbert Walter . . . . . 22
	Richard Pipes . . . . . 28
	Dimitri Simes . . . . . 32
	Steve Meyer . . . . . 37
	Edward Luttwak . . . . . 43
	Henry Kissinger . . . . . 47
III.	List of Participants . . . . . 52
Annex 1	Seminar on the Soviet Union . . . . . 54
	October 30, 1991



# Colloquium on the Former Soviet Union for the Executive Directors of the World Bank

Socialist Economies Reform Unit, Country Economics Department

February 27–28, 1992

Westfields International Conference Center

## Agenda

### **Thursday, February 27, 1992**

2:00 – 3:00 pm

*Light Lunch*

3:00 – 4:00 pm **Introduction and Impact on the World Economy of the Soviet Transition**

*Presenter:* Lawrence H. Summers, Vice President Development Economics and  
Chief Economist

4:00 – 6:00 pm **The Current Economic and Political Situation in the Various Republics**

*Presenters:* Anders Aslund, Stockholm School of Economics

Strobe Talbott, *Time Magazine*

*Commentator:* Abel Gezevich Aganbegyan, Academy of National Economy, Moscow

6:00 – 7:00 pm

*Cocktails*

7:00 – 9:00 pm

*Dinner*

**Economic Reform in the Russian Republic and the Role of Foreign Aid**

*Presenter:* Jeffrey Sachs, Harvard University

### **Friday, February 28, 1992**

8:00 – 9:00 am

*Breakfast*

9:00 – 10:30 am **International Perspectives on Recent Events and on the Role of  
Foreign Aid**

*Presenters:* George Soros, Soros Fund Management

Norbert Walter, Deutsche Bank

10:30 – 10:45 am

*Break*

10:45 – 11:45 am **The Prospects for Political and Economic Reform:  
The Sovietologists' View**

*Presenters:* Dimitri Simes, Carnegie Endowment for International Peace

Richard Pipes, Harvard University

11:45 – 1:00 pm **The Security Problem**

*Presenters:* Steve Meyer, Massachusetts Institute of Technology

Edward Luttwak, Center for Strategic and International Studies

1:00 – 2:30 pm

*Lunch*

*Presenter:* Henry Kissinger, Kissinger Associates, Inc.



# COLLOQUIUM ON THE FORMER SOVIET UNION FOR THE EXECUTIVE DIRECTORS OF THE WORLD BANK

SOCIALIST ECONOMIES REFORM UNIT  
COUNTRY ECONOMICS DEPARTMENT  
FEBRUARY 27-28, 1992

## SUMMARY OF MAIN POINTS

Cheryl Gray

*On February 27-28, the Socialist Economies Reform Unit organized a colloquium on the (former) Soviet Union for the World Bank's Board of Executive Directors. The goal was to provide an in-depth picture of the current political, economic, and military situation in the region, prospects for the future, and the international impact of these developments. Outside experts participating in the program included economists Abel Aganbegyan, Anders Aslund, Jeffrey Sachs, and Norbert Walter; Sovietologists Richard Pipes and Dimitri Simes; and political/military experts Henry Kissinger, Edward Luttwak, Steve Meyer, and Strobe Talbott. The main points of the discussion are summarized below.*

1. **The present situation in the former Soviet Union is marked by chaos and extreme fragility--**in the words of George Soros, the situation is "not just grim but potentially cataclysmic." On the economic front, output is falling rapidly across the region with no immediate end in sight. Interrepublican trade is in threat of collapse, with potentially catastrophic effects on the economy of the region. On the political front, a variety of personalities from the former Communist party, the military, and national minority groups are emerging in Russia to challenge President Yeltsin. Although they represent potentially antagonistic viewpoints, these groups are beginning to unite in opposition to Yeltsin and thus to pose a growing threat to his already fragmented base of power (itself undermined by competing regional and local power bases within Russia). With regard to the other Republics, only the Baltics and Armenia appear to have relatively well-established democracies with an influx of new, reform-minded leaders. Old communist party officials are essentially still in charge elsewhere, although with varying degrees of reform in political institutions. All republics except Russia suffer a severe shortage of economic and legal expertise. Because power in the former Soviet Union was highly centralized in Moscow, the other republics face a virtual institutional vacuum as they approach the tremendously complex task of political and economic transformation.

2. **Furthermore, Russian history does not provide great cause for optimism that democratic institutions and capitalist economic concepts will necessarily take hold.** Past attempts to create a liberal political environment have failed. As noted by historian Richard Pipes, communism gained control in Russia in part because it reinforced certain characteristics of traditional Russian political and economic culture. First, Russian folk culture has generally preferred strong--but not necessarily benign--government. (Ivan the Terrible was, in strict translation, really Ivan the "Awesome" and is not considered a particularly bad character in Russian history.) Second, concepts of private property and rule by law had shallow roots even in pre-communist times. Until two centuries ago, Russian monarchies were all-powerful and owned all property and even all people. The concept of private land ownership was unknown in traditional Russian communes; serfs were allotted relatively equal

plots of land to use, but ownership and responsibility for paying taxes was communal. Egalitarian notions are deeply embedded in the Russian people. Third, Russian society has always been atomized, with poorly developed lateral ties. Until the late 19th century Russians were not allowed to form independent organizations such as political parties or trade unions. Thus the disintegration of the state always meant the disintegration of society. This failure to organize has persisted, and even now nothing like Poland's Solidarity movement has emerged in Russia. Only the intelligencia has been somewhat united--but only in opposition. Attempts on their part to organize around a common consensus have failed.

**3. There are, nevertheless, some signs of hope in the current situation.** This is the first time in history that Russia has a chance to shed its old political and economic traditions and build a new society from the bottom up. There are signs that the last 70 years have been so traumatic that the population is truly willing to endure hardship if needed to bring fundamental change. The time for change is ripe and should be seized by insiders and helped by the international community. This is certain to be a watershed period--for good or for bad--in the region's history.

On the economic front, several republics are indeed taking unprecedented steps at reform. Russia is the most obvious, with its dramatic stabilization and price deregulation in January that reduced the budget deficit from 25 to perhaps 5 percent of GDP. Although the enormous price leaps and collapse of the ruble in January led to a corresponding freefall in confidence, the significant appreciation of the ruble in the last two weeks is the first sign that stabilization efforts may be grabbing hold. A large increase in oil prices is planned for April. It will dramatically shift the terms of trade--and possibly the political and economic tide--in favor of Russia against all other republics.

Although the most visible case, Russia is not the only republic pursuing economic reform. Lithuania is moving vigorously, while Estonia, Latvia, Armenia, Kazakhstan and Kirgizstan are making some (albeit more limited) progress. Conditions in Belarus and Ukraine are amenable to reform, but these republics in particular need technical assistance from the international community. The Central Asian Republics, Azerbaijan, Moldova and Georgia are the slowest to pursue reforms.

On the political front, it is striking how political pluralism has broken out in certain parts of the region for the first time. As noted above, several centers of real power are emerging in Russia to challenge the Kremlin. Democracy is also well-established in the Baltics and Armenia. This coming of "real politics" would be easier if the economic conditions were not so harsh and thus so conducive to the emergence of extremist political groups.

**4. Recent events in the Soviet Union also bode well for international security.** Russia is increasingly looking inward, absorbed by problems with its own national minorities and economic power centers. Orders for military equipment have fallen 85 percent, leaving military industries in a state of shock and rapid disintegration. Although they are trying to export arms to recoup some of their losses, the level of exports is certain to drop dramatically from that pursued (through sales and military aid) by the former communist regime. Although widespread conversion of military industries to civilian uses is not feasible, some inputs (including labor) can be redirected over time. In contrast to rather alarmist speculations in the press, the danger of nuclear proliferation has *not* been enhanced by Soviet disintegration. The highly sophisticated and complex controls on nuclear weapons will continue to prevent unauthorized use, whether by rogue military bands, international terrorists, or

indeed republican governments (other than Russia) themselves. Furthermore, the well-publicized demand for ex-Soviet scientists has itself been overemphasized as a danger. Even if these scientists wanted to move (which is questionable), they would add little value in other settings given their narrow base of knowledge (generally tied to Soviet weaponry) and the general shortage of engineering machinery (not of knowledge) in most would-be importing countries. In the nuclear area, the major threat to the West is posed by the dozens of Chernobyl-type nuclear plants still in operation. The only major threat to international security potentially arising from the current situation would be if Russia were to renew its past imperialistic tendencies and attempt to reunite part or all of the empire by force. For this reason the West needs to establish strong links with the other republics and encourage normal Russian-Ukrainian relations.

5. Finally, one must not overlook the tremendous accomplishments to date. Few would have predicted a few years ago that a peaceful dissolution of the Soviet empire was possible. This is the third great transformation of the 20th century--and the first two (the two World Wars) resulted in 60 million deaths. The CIS is now providing an institutional framework for a peaceful third transformation--a critical role even if the CIS eventually becomes, in the words of Strobe Talbott, "little more than a footnote in history."

6. International assistance is critical if the chaotic and fragile situation is to develop into one of hope rather than cataclysm. The exact role for the West is, however, under debate. All experts agree that basic humanitarian assistance, such as emergency imports of food and medicine, is needed. Most also favor Western contributions (perhaps on the order of \$5 billion) to a stabilization fund to provide support to the ruble, and some call for additional monetary assistance (with strict conditionality) to promote nonessential imports and debt rescheduling--although many doubt that this money will be forthcoming given the disgruntled electorate in the West. Although Western technical assistance is also needed, the focus and amount is open to debate. Some experts look to the east German model and call for massive migration of expertise--particularly managerial expertise--"from West to East" to help in rebuilding public and private institutions. Others take a more cautious approach, calling on the West to help in transferring technical know-how but to leave it to the Russians and other nationalities to rebuild their own indigenous institutions. Although the process could take a generation or two, this is short given the centuries of Russian history whose legacy needs to be overcome if democracy and a private market economy are to take firm root.



# **COLLOQUIUM ON THE FORMER SOVIET UNION FOR THE EXECUTIVE DIRECTORS OF THE WORLD BANK**

**SOCIALIST ECONOMIES REFORM UNIT  
COUNTRY ECONOMICS DEPARTMENT**

## **PRESENTATIONS**

**Lawrence H. Summers  
Vice President Development Economics and Chief Economist**

People always say the world is at a crossroads. But now it is really true. The Cold War is the third great war that has ended in this century. After World War I, the world turned inward and pursued nationalist economic policies. No effort was made to reconstruct the defeated society and the result was a 20-year period of very poor economic performance followed by another world war. After World War II, the defeated nations were successfully reintegrated. New international institutions, including the World Bank, were created and barriers to trade were reduced. A 25-year period of the most rapid economic growth in the history of the world followed.

One dares to think that now, at the end of the Cold War, we are at a similar turning point. The success of efforts to assist the Soviet Republics in rebuilding their economies will have a great deal to do with whether the post-World War I or the post-World War II scenario is played out over the next several decades.

In making some brief introductory remarks I would like to talk a bit about the history that has led us to this point, say a few words about the international significance of changes in what was once the Soviet Union, and then make a few narrower comments about today's program.

### **Why did the Soviet Union Collapse?**

I think the place to start in looking at this question from an economic perspective is to recognize just how much of an underachiever the Soviet Union has been economically. The Soviet Union is extremely poor given the quality of its resources, most obviously its natural resources--petroleum reserves comparable to those in the Middle East and reserves of a wide variety of commodities that are far greater than those possessed anywhere else in the world.

Soviet underachievement extends to its human resources as well. The former Soviet Union grants one third of the world's doctorates in science and engineering and devotes more resources to research and development than Japan and the United States combined. And there is ample reason to think that there is a lot of human potential in their labor pool. If one looks back to the period prior to the Bolshevik Revolution, a strong case can be made that the Soviet Union was on the brink of industrialization; the growth rates of industrial production prior to the Russian Revolution far exceeded those in the United States or in Europe. And even with all of the current difficulties in Poland, Russian workers find jobs easily and are far more prized by Polish employers than are Polish workers.

Some suggest that the legacy of Communism causes people to be unwilling or unable to work and makes market economies difficult to introduce. Surveys of the Soviet population, however, suggest otherwise. The fraction of people who say that workers should be paid on the basis of their productivity rather than a fixed wage is greater in the republics of the former Soviet Union than in Europe and the United States. The number of people who think that it is fair to raise prices of goods that are in scarce supply is similarly greater in the former Soviet Union than in Europe.

What, then, went wrong in the Soviet Union? It is obvious enough that the present economic collapse had something to do with the Communist system and the decay that set in. Yet simply saying that prices are distorted, budget constraints are soft, and planning does not work is not enough to explain the resulting problem. Only thirty years ago people were writing that growth rates in the Soviet Union exceeded those in the rest of the world, that the Soviet system would be the wave of the future. The questions one therefore has to ask are first, why did the economy slow down to the point that between 1970 and 1985 there was essentially no economic growth? And second, what caused the collapse of the last few years?

I believe that the slowdown was first and most importantly a consequence of the accumulation of distortion as the system moved away from its market roots. Prices were initially fixed near market levels. As time went on, however, prices drifted further and further from market levels and barriers to new firms became a larger problem. In addition, the politicization of economic life led increasingly to appointments being based on loyalty rather than on competence with the attendant consequences for productivity. To a substantial extent, therefore, the system was dying of its own weight.

The second force that accounted for the slowdown was the fact that the Communist system was particularly ill adapted to modern conditions of production. It is probably no accident that the slowdown in the Soviet Union coincided with the slowdown in import substituting countries around the world. Where bureaucratic command and control production had some capacity to organize and increase the volume of steel production, its capacity in other areas was much less. Two years ago, the number of computers per capita in the Soviet Union was one percent of the number of computers per capita in the United States. Societies that lock up Xerox machines are ill equipped to adapt to the information age.

The third cause of the slowdown was the external factors that stressed the system, two of which were especially important. The first of these was the oil shock. The early signs of the slowdown were hidden by the dramatic windfall that a major oil producer received when the price of oil rose nearly ten-fold during the 1970s and then magnified when hard currency receipts declined sharply with the fall of oil prices in the 1980s. In addition, the continuing attempts at matching the substantial increases in western defense spending during the early 1980s were important sources of stress on the system. With income between one-fifth and one-tenth of American income, matching a one percent GNP increase in NATO defense spending meant expenditure of between 5 to 10 percent of Soviet GNP.

For these reasons the communist system was grinding to a halt by 1985. But this does not explain the kind of dramatic collapse and conflagration that we have seen in the last five years. It is worth remembering that there was no assurance that there would be this kind of dramatic political change. Andropov and Chernenko could have lived considerably longer than they did. Gorbachev

was chosen on a 5 to 4 vote over an alternative candidate with what appeared to have been much less progressive leanings.

What are the causes of the Soviet system's ultimate collapse? I believe that in its economic aspects this question can be answered more definitely than the earlier slowdown. The collapse was basically caused by the incoherence at both the microeconomic and the macroeconomic levels of Gorbachev's program. At the microeconomic level, a highly distorted price regime has to go along with quantity control. If oil is going to be sold for two cents a gallon, it is not advisable to let people buy as much as they want. Similarly, if enterprises are going to be subject to 100 percent taxes, if revenues go to the state, and if the government makes up any losses, industry needs external pressure to achieve some kind of efficiency. Creating freedom without changing prices or underlying incentives was a prescription for microeconomic chaos.

Layered on top of microeconomic disorder was macroeconomic disarray. As we well know, inflation is a problem everywhere, but repressed inflation is an even greater problem. In most countries, too much money chasing too few goods leads to rising prices. With controlled prices, too much money chasing too few goods leads to longer lines, more diversion from controlled to uncontrolled markets, and reductions in output as people spend more time queuing and less time working. This in turn was magnified by the political difficulties (which others here are much more competent than I to discuss) which made it very difficult to levy taxes effectively and to control the supply of money.

It is this microeconomic and macroeconomic disarray which led to the problems of 1990 and 1991 and the critical situation of today. It is probably no exaggeration to call it the most difficult economic reconstruction job in the history of the world.

One way of highlighting the difficulty of rebuilding the Soviet economy is to contrast the economic situations of, for example, the Russian Republic and Poland. Poland's decline in output is among the more drastic that the world has seen. But the situation in the Russian Republic is very different. The republics of the former Soviet Union are, in every relevant sense, much further from the West. To take just one statistic, the number of Chinese students who went abroad last year is more than the number of Russians students who have been abroad since World War II. And one of the things that kept Polish reform going in its early stages was the ability to drive a pick-up truck from Warsaw to Frankfurt and back to Warsaw in a weekend. This clearly cannot be done from Vladivostock.

In addition to being further from the West, the Russian economy is even more distorted than the economies of Poland and the rest of Eastern Europe. Prices in the Soviet republics are further from Western prices and the Soviet budget deficit, which exceeded a quarter of GNP by the end of last year, is much greater than it was in Eastern Europe. The defense establishment, which has to be dismantled, is much larger. The presence of private firms is much less. And there is, of course, the additional difficulty that what was once one country is now 15 and pressures to further break up these republics still exists. Some 65 million citizens of the former Soviet Union live in areas where they are not the majority ethnic group.

## **The Significance of Today's Situation**

At this point I am going to stop the discussion of what the economic problem is, sort of in the style of the novelist who says, "and our hero's at the bottom of a well and they are shooting flaming arrows down at him" and then begins the next chapter by saying, "having escaped from his predicament, our hero ..." and leave the task of describing the strategies for emerging from this situation to our various speakers. But I do want to speak of the international significance of the events that are taking place in the former Soviet Union.

It seems to me that the topic can be divided into three types of linkages between what is happening in the Soviet Union and in the rest of the world. The first of these linkages is what I would think of as the narrow economic linkages. Considering what a superpower the Soviet Union was, these linkages are surprisingly small. In fact, with almost nobody noticing, the Soviet share of world trade declined from 3.4 percent in 1983 to 1.8 percent in 1990. That means that even if the Soviet republics ceased all involvement in world trade, the change would not be substantially larger than that which we have already observed.

There are a lot of estimates as to how much capital is going to flow and how much debt repayment is going to come from the Soviet Union. But the operative thing to remember is that the world pool of investment is in the 4 trillion dollar range while every number associated with the Soviet Union on an annual basis is in the sub-50 billion dollar range. In the broadest sense, therefore, this is not a major event for the world trading system or for the world capital market.

The Soviet collapse is a significant event for the nations that were previously its major trading partners and allies-- primarily, but not exclusively, the communist countries. In the last two years, Soviet trade with Eastern Europe has declined by nearly half. On any sensible estimate, this accounts for a substantial part, or perhaps even the vast majority, of the Eastern Europe output decline. Some restoration of trade between the Soviet Union and Eastern Europe is probably the most important external linkage.

The Soviet Union also accounts for significant shares of trade and financial flows with previous client states-- Viet Nam and Cuba being two obvious examples-- and for close to 10 percent of India's trade. It is also surprisingly important in certain commodity markets. On some estimates, the consequence of the Soviet depression and the resulting decrease in the demand for tea and coffee will mean as much as a 10 to 15 percent reduction in the world price of these goods. And the breakdown of the Soviet-Cuban relationship is transforming the world sugar market.

The second linkage between the Soviet collapse and the rest of the world comes from a Russian proverb, answering the question "what is it like to be in the forest with a wounded bear?" The consequences of this situation are much more significant than the narrow economic linkages and involve three separate risks. The first and most salient risk of coexisting with a wounded Soviet Union is the possibility of the unauthorized use of nuclear weapons or of the expertise to create them falling into the wrong hands. Thirty thousand nuclear weapons need to be dealt with in coming months.

The second risk, and one that I think probably gets less attention than it deserves, is the environmental threat. In a long-term sense, there is the concern that with heavily subsidized energy,

the Soviet Union is a substantial contributor to the global warming problem, accounting for something approaching 10 percent of global emissions. There is also the concern about the number of Chernobyl-like power plants that are still in operation which may be as high as 50.

The third risk created by the current situation is the threat of large-scale migration and its geopolitical consequences. It is very difficult to gauge the extent of this threat and it will certainly depend upon the rate of recovery in the former Soviet Union and on the response of potential recipient countries. It bears emphasis that annual flows of migration into Western Europe are relatively low compared to levels of earlier years or those the United States experiences annually.

The third, and surely the most benign international linkage of the Soviet collapse, is the end of the Cold War. Obviously, this means substantial reductions in defense spending worldwide. A reasonable estimate is that by 1996 Western defense spending will have declined by \$150 billion a year. And nations will cease pursuing policies necessitated by the Cold War; relations between donor and recipient nations will no longer be characterized by the possibility that the recipient country would turn to an adversarial source of assistance. The end of the Cold War, however, also takes away the common external threats that encouraged agreements between nations, therefore threatening international cohesion and stability.

It is interesting to ask two questions. With the Cold War still on, would there have been a war in Iraq? And with the Cold War still on, would we still be trying to conclude the Uruguay Round? I think it is reasonable to conjecture that if the Cold War had continued, there would not have been a war in Iraq because the risks of explosion into superpower conflagration would have been too great. And it is likely that the Cold War would have put greater pressure for agreement on the United States, Europe, and Japan and we would have seen the completion of the Uruguay Round by now.

### **Today's Program**

The pessimistic view emphasizes that the last time a war ended and there was neither a clear leader nor a common security threat, the result was the 1920s breakdown of the international economic system. Successful reconstruction of the republics of the former Soviet Union will contribute to minimizing the economic disruptions, security concerns, and probably to reaping dividends from the end of the Cold War. That is why the Soviet republic's reconstruction efforts carry grave international significance.

The program we have assembled for this day-long colloquium has tried to approach these problems as broadly as possible, avoiding a focus on only the narrow economic aspects of reform strategy. In the course of this program we will discuss the economic issues as well as the geopolitical and internal political aspects, maintaining some focus on the urgent question for this institution-- what can the rest of the world do to assist in this historic and vital reconstruction effort?

**Strobe Talbott**  
**Time Magazine**

Thank you Mr. Naim. As you can tell from Mr. Naim's introduction, I am something of a journalistic Typhoid Mary. The only two countries that I have ever actually been posted to as a journalist are Yugoslavia and the USSR. So, I think against that background, all of you can hope that I am never posted to your country to live and work as a journalist.

Drs. Aslund and Aganbegyan are going to be in the position of giving you a virtually up-to-the-minute perspective on developments in Russia. I, however, am going to begin with what I think better qualify as historical observations. I call them that because I was last in Moscow nearly three weeks ago. And as all of you know, events are moving so fast that last month already qualifies as history, I am tempted even to say as *ancient* history.

In order to conserve as much time as possible for the discussion, which I am sure will be the centerpiece of this afternoon's program, I am going to confine myself to broad-brush observations in three general areas: one, politics; two, the role of the military; and three, the nationality question. I will take them one at a time.

First, politics. What struck me most during my most recent visit to Moscow, was how pluralism has broken out in that country, and that is a country which has no such tradition in its political culture. The old system -- the Soviet system -- was in its essence, an institutionalized conspiracy. It was hierarchical and centralized. Politicians needed to look in only one direction: upward at their masters who gave them their orders. Now, politicians must also look downward to their constituents for support, and sideways to their colleagues for alliances and horse-trading deals.

One of the things that struck me as a reporter who has been going to that country for 23 years, is how recently the Kremlin has become no longer the kind of be-all and end-all of places where you want to get appointments when you are there. The Kremlin is now just one of a number of centers of real political power. Much of the important political action going on in Russia now is in the Parliament.

Several of President Yeltsin's former prodigies, i.e. men who owe at least the most recent stages of their careers to him, have turned against him, and are developing independent power bases. One of these is the speaker of the Russian parliament, Ruslan Khasbulatov. Another is Vice-President, Rutskoi. Now, while both of these men are unquestionably manoeuvring against President Yeltsin, they pretend that they are criticizing not "the President" but "the Government." Yet they, along with everyone else, know that Yeltsin is not just the President of Russia, but also the Prime Minister, and thus the head of the government.

During my recent trip, I heard a number of people suggest that because of this political awkwardness or vulnerability for President Yeltsin, he is likely to name a separate Prime Minister in the fairly near future. I might add, and this is a point we can come back to in discussion if you wish, that the issue of Yeltsin himself, his indispensability to the current stage of Russian politics, is a problematic issue. Not least of all, because there are serious questions, very persistent rumors, some of them from people I tend to credit, that his health is in very bad shape. There is really on the scene at the moment no clear alternative to President Yeltsin.

Certainly the two gentlemen that I mentioned a moment ago I don't think qualify. Mr. Khasbulatov, in addition to being already out of his depth in some ways, also has the disadvantage of being a non-Russian. He is a Chechen from one of the Muslim enclaves in the southern part of Russia. And Vice-President Rutskoi got his position on the ticket for the Russian vice-presidency last year for reasons of very short-term political expediency. He was an Afghanistan war-hero, whom Yeltsin brought on to the ticket in order to assure himself support from the military. But very few people that I know think that Vice-President Rutskoi would make an effective president of Russia.

But the overall point that I want to make is this: in many ways the coming of what I call real politics to the former USSR, would be a thoroughly healthy and welcome phenomenon, if it were not occurring in a context of an economic crisis of vast proportions. Popular discontent with the reforms of the Yeltsin government could translate into support for some extremely unsavory characters, who are now gathering support and manoeuvring on the political stage.

For example, the most notorious and the most often cited, is someone of quite clearly fascistic and neo-imperialistic leanings by the name of Vladimir Zhirinovskiy. He garnered about 6 million votes in last year's Russian presidency election. I spoke to someone who is intimately familiar with polling data, who suggests that Zhirinovskiy would do twice as well in terms of popular support if a presidential election were held today.

There are also at least six off-shoots of the old, supposedly disbanded, technically illegal communist party. But some of those are now appealing to the liberal constitutional principle of political freedom in a campaign to re-legalize themselves.

One theme in conversations in Moscow these days, or at least three weeks ago, was the danger of a political marriage of convenience between what are called the Browns and the Reds, that is between the Russia-Firsters or the ultra-nationalists, some of whom as I say have fascistic leanings, and the Reds -- the die-hard believers in the old regime.

Another force to be reckoned with is the army. Even though its senior officers are overwhelmingly Russian, they continue to insist on allegiance to some entity larger than the Russian federation. General Yevgeny Shaposhnikov, in his capacity as commander-in-chief of the army, is answerable not to President Yeltsin but to a committee made up of the leaders of 11 former republics. In fact, Shaposhnikov is sometimes called the 12th member of that committee, which is to say he is not really answerable to anyone.

Many in the military, I believe, want to keep alive the idea that Russia belongs to, and has power over, something larger than itself. The generals and admirals, and I suspect quite a few colonels and naval captains as well, are reluctant to see Russia demoted to the status of merely a regional power. Many of them dream of restoring Russian military might to a level of a global superpower. And that gives them something in common with the communists, who dream of reconstituting their party with its internationalist mission, and it also gives them something in common with expansionist-minded Russians, nationalists like Zhirinovskiy, who dream of reconstituting at least territorially the Czarist empire, including not just breakaway former Soviet republics like Ukraine, but all of Finland and parts of Turkey as well.

All of which is to say that you've got in the background of today's headlines out of Moscow the makings of a tripartite unholy alliance, made up not just of the Red and the Brown, but the olive drab and the navy blue as well. To pick up on Larry Summers' metaphor, and maybe to mix it a bit, there is actually a troika of wounded bears moving around in this particular forest. They're growling louder than before, and they are beginning to growl in unison.

Now the mention of empire and imperialism raises the third and last point that I want to put before you this afternoon. It concerns the nationality question. My own view, for some time, has been that we on the outside tend somewhat to exaggerate the importance of ethnicity per se. And correspondingly to underestimate economics as the fuel that drives the disintegration of the state.

A lot of the commentary and analysis that we read now, and particular that we read in the West last year while the USSR was ceasing to exist, suggested that the Armenians, Moldovans, Uzbeks, and so on, wanted out of the old Soviet Union because they were anti-Russian, and because they were venting long pent-up resentment of Russian cultural domination of their republics. Without doubt, nationalism, tribalism, call it what you will, has played, continues to play, and will continue to play an important role. But I have felt for some time that the force fueling secessionism is also economic. What those people really wanted out of, was the Soviet system. It was to escape the clutches not just of the Red Army, but of the ruble.

This realization came to me with great vividness on two occasions in recent years. I visited Vladivostok in 1990 and found many of the city fathers there -- even though they were in the main Russians -- almost as eager to break free of Moscow's grip as any Ukrainian or Georgian. And then in June of last year, I visited Ukraine and found the ethnic Russian citizens of that republic just as determined to break free of the Soviet Union as ethnic Ukrainians.

The economic centrifugal forces that led to the disintegration of the USSR in 1991 are continuing to rend asunder Russia itself in 1992. We are seeing secessionist movements right now, inside Russia, among Mr. Khasbulatov's fellow Chechens in the Caucasus, and also among the Tatars in the Kazan region. Those forces certainly operate within the Commonwealth of Independent States as a whole, ultimately perhaps dooming that entity to being little more than a footnote in history.

If Winston Churchill were around today, he might call the Commonwealth a misnomer wrapped in a contradiction inside a political fiction. After all, the word "commonwealth" presupposes there is wealth to have in common, whereas what the pieces of the former Soviet Union have in common is poverty, and little prospect of improvement. Until the people there associate the larger political grouping of which they are a part with hope for a better future, they will continue to pull away from the center. They will continue to look for excuses to undermine the structures associated with the center and to defy its leader. And if we can see that trend looking from the outside, obviously so can Mr. Zhirinovskiy, the communists and the military looking at it from the inside. All of them favor the restoration of a powerful and authoritarian, if not totalitarian, center. They may sense that they have an ever-narrowing moment of opportunity to make their bid for power.

That is why the coming months, I think, are so critical. We have already seen in the benighted country of Georgia a reminder that democratization of the system does not necessarily produce democratic leadership. And we can see that paradox played out again in Russia itself. If that happens, it will be because political reform foundered on the shoals of economic failure, it will

be because the coming of real politics and pluralism has combined perversely with popular discontent and despair to create the conditions for the return of dictatorship.

That does not have to happen. I am not as pessimistic as many of my Russian friends on this score. I don't think disaster is inevitable. I still believe Russia can muddle through, albeit with a certain amount of staggering and lurching and its current course of democratization, demilitarization and decolonization.

But about one thing I am quite sure: What happens next, whether worse comes to better, or worse comes to worst, depends on whether economic reform begins to show signs of working in ways that are evident and palpable to the citizenry.

**Anders Aslund**  
**Stockholm School of Economics**

My intention here is to bring out a few important aspects of the various republics in the former Soviet Union. I think these are the most important perspectives that need to be brought out.

1. To begin with, we have the level of economic development in the various republics. We can divide the former Soviet Union into three groups. First, we have those republics that are richer than average: the Baltic republics, Armenia and Georgia; then we have a group of republics around the level of Russia; then we have the rest, that is essentially Central Asia, which is significantly poorer than Russia.

If you look up the official statistics, Armenia and Georgia seem to be at approximately the same level of economic development as Russia, but that is clearly not true. If you instead look into studies of the second economy, you find that ethnic Armenians, living in Armenia, according to a study by Gregory Grossman and Vladimir Treml, 64% of their personal incomes came from the private sector in the mid-1970s, while the corresponding figures for central Russia was about 20%. By and large, we have much more independent economic activities towards the south. There are more independent activities in the Ukraine than in Russia and in this way Armenia and Georgia are in fact, though not in the official statistics, among the richer.

2. Another important aspect is, how the main nationalities have been represented in the administrations: There are five republics where the basic nationality was heavily over-represented in the republican administrations during the mid-1980s; namely the Baltic republics, Georgia and Armenia. Compared to Moldova where the native nationality was heavily under-represented. It is exactly in these five republics, the three Baltic republics, Armenia and Georgia (the richest and also where the native nationalities were doing best within their own republics), where we saw the strongest drive towards independence first. On the contrary, the Central Asians are laggards and cautious, still trying to stick as far as possible to Russia. Belarus simply feels a considerable affinity to Russia, the only one of the former Soviet republics that can be considered to be truly close to Russia.

3. A third aspect that I think is very important for economic reform is the degree of democratization. Democratization I would argue, can be measured in obvious terms such as free elections and a free press. Another standard is whether the Communist party is effectively still in power or not. Of course the Communist party has been abolished by-and-large but, in many cases we see former Communist officials staying in power anyhow. A third standard is if the nomenklatura in broad terms is still dominant. I think this is important. We see in eastern Europe that no fundamental, systemic change has taken place before proper democratization. Also, no democratization has taken place without substantial systemic reform coming very soon afterwards.

How do the various former Soviet republics rank in terms of democratization? Well, at the top of the list we have Lithuania and Armenia, where we had a thorough democratization. The Communist party is gone and the nomenklatura does not hold power any longer. Then we have an intermediary category of Russia, Estonia and Latvia. I think that these are proper democracies and that the communist parties do not rule under any new cover, but there is still a large number of nomenklatura left at rather high levels of power. You can see for example in Estonia that the president appointed in 1983, is still sitting. After that we have Belarus and Ukraine, where you have had democratization which looks proper but old party officials are still running these states. It is

therefore rather difficult to assess the degree of actual democratization. It looks like a Bulgaria before the parliamentary elections last year.

Besides this, we have two republics which are in severe domestic trouble: Georgia and Moldova. Georgia, one must say, has really thrown out the old ruling groups. On the other hand, it is not clear what rule there will be or what will be ruled, so, what can I say. In Moldova, we have extreme national tensions. You have a typical first party secretary who is still running the country, now as president.

What remains here are the five central Asian republics and Azerbaijan. With the exception of Kirgizstan, the Communist party is still in charge. The worst case is Tajikistan, where the Communist party leader who was kicked out by Gorbachev in 1985, came back through the elections last year and one must be rather dubious about what those elections actually meant. For example in Uzbekistan, two opposition parties were not allowed to put up their candidates in the presidential elections. In several elections in these republics, there have been majorities of over 98% -- which is not what you normally connect with democracy. Kirgizstan also falls in this group, though among this group, Kirgizstan and Kazakhstan look comparatively more progressive.

The worrisome aspect that I would like to bring out is that apart from five or six republics in the west, in most cases the communists are still holding power under some kind of nationalist cloak. This is exactly what we have seen in all the former Yugoslav republics, whereby, they try to strengthen their position by being nationalistic rather than democratic. In that connection, we also see the former Yugoslav republics not being particularly interested in economic reforms.

4. A problem that we see all over outside of Russia, is a severe shortage of the crucial human capital needed. I am thinking in particular of economic policy makers. In Russia, you have them in abundance. We may discuss their quality, but they are there. In the other republics, I would simply say that it looks quite a bit like Africa in 1960. There are no people who are used to running the central government functions because they were run from a distant center before. This is not to say anything about technical capabilities, of course education is very high and so forth, but these central government functions were simply run from Moscow (a good example here is the Ukrainian national bank which last summer still had seven employees) so that the basic institutions of a state do not exist. While there is a big problem with economic policy makers, there are even fewer lawyers.

5. Moreover, the legislatures are formed for a completely different purpose. You can say that the Russian legislature is focused on the democratization of Russia, while the legislatures of the other republics are strongly focused upon national independence, which means that they are more concerned with national symbols than with boring things like laws or economic reform. Also, the most significant political personalities tend to be poets and musicians rather than economists or lawyers. As a natural result of this, the laws that are adopted are poor and frequently too few laws are adopted.

6. Moving on to reform programs, Russia, the Baltic republics, Armenia and Kazakhstan can be said to have general reform programs for their economies. On top of that, we have the Russian price liberalization of the 2nd of January, which has proliferated through the other republics and forced them to adjust to the reforms that have been introduced in Russia. It was only the Baltic republics that had undertaken price liberalization before Russia, gradually, during last year.

7. On privatization it seems that Armenia has gone furthest. It has already undertaken land reform. The country that has launched a substantial privatization scheme with voucher privatization is Lithuania, where privatization is going ahead on a grand scale; while Estonia and Latvia have very messy privatization regulations, which are moving slowly -- to a considerable extent because their basic idea is that any Estonian or Latvian who ever owned any property in these republics, should have it given back to them. This complicates the privatization process.

Russia has started a privatization program which is very ambitious indeed, though not yet particularly well elaborated. Apart from that, Kazakhstan has done a bit of privatization already, in particular, selling small shops. Also in the other republics there is some privatization. For example in Ukraine, it is large scale, nomenklatura privatization: a couple of thousand enterprises have been taken over by previous directors and party officials in one way or another. The privatization moves are going very irregularly. In Georgia, a lot of privatization has also occurred, though I'm not quite sure how it has been done.

8. The main question for the future might be the economic relations between the different republics. In general we can say that, the former Soviet republics are extremely dependent upon each other. It is easy to see from the size of the different republics how dependent they are on trade with the others. For Russia trade with the other republics accounts for about 1/5 of its GNP, Ukraine and Kazakhstan come next. The central Asians generally trade 40-50% of their GNP with the other republics, while for the rest of the small European republics, about 60-70% of their GNP is trade with other republics. This means an extraordinary degree of interdependence. When prices change, the terms of trade will also change. What we can say for certain, although the figures are open to dispute because we don't know what the eventual prices will be, is that all the republics will lose to Russia, and many will lose heavily. What we are about to see is approximately what we saw when the CMEA trading system collapsed last year.

The big change is that almost all the republics will have to pay much more for oil from Russia. For the time being, a big price increase is scheduled for April, when the Russian oil prices are set to go up from 50 cents a barrel, to something like 1/3 of the world market price for oil at the current market determined exchange rate. We may assume that a number of republics will get a deterioration in terms of trade by at least 50%. So this would be a very radical change and it might even be more.

The attitude of the different, former Soviet republics to the problem is quite different. The central Asians are very aware of it, they have previously gotten straight budget subsidies from the Union -- read Russia. Therefore, they are trying to keep as close as possible to Russia in order not to lose the benefits that they used to receive. The Baltic republics and Ukraine, on the contrary show the least understanding of how much they will actually lose when real world market prices are introduced. This leads me naturally to currency reforms.

9. I think that it is important to notice that currency reforms and currencies used, are first of all a political issue. It is a question of who wants to pursue his own economic policy, monetary, and fiscal policy, and is not prepared to bow to Moscow. Essentially we have three groups of republics in this regard. Ukraine and the Baltic republics are preparing currency reforms and are likely to undertake currency reforms in the middle of this year or so. Moldova and the three Caucasian republics have declared that they want to undertake currency reforms but they don't seem to be

preparing themselves for it. The rest, that is seven republics, the five central Asian republics, Russia and Belarus, appear intent on staying in the ruble zone. What I think is important is that this issue is sorted out. It is less important which republics get independent currencies or not. When currency reforms take place the existing currency should occur and the whole currency reform should be undertaken in one, big go.

The most worrisome case is Ukraine, where there is a system with two different currencies, none of which is convertible. Part of the salaries are paid in something called coupons, which essentially is a new currency but while you can buy many things for coupons in the Ukrainian shops, the shops cannot use those coupons for further deals. There is a free market between coupons and rubles but the exchange rate is fluctuating widely without any stability in the system. There has been a worry among Russians, that rubles will start overflowing into Russia. After some time, Ukraine wants to introduce its own currency, the Hryvna. The current Ukrainian idea is that it should be introduced in several steps, then, Ukraine would get three different currencies, none of which is convertible -- a perfect mess. This is clearly an issue for international economic agencies, which should explain what should be done. The problem is not any particular idea but just a general confusion.

Why has this happened? The concrete reason why Ukraine started issuing the coupons is that there was a shortage of bank notes. The Russian central bank does not deliver enough bank notes to the other republics so that they can pay salaries in time. There is simply a physical shortage of cash. Since inflation has been rising very fast, money printing is lagging behind and the backlog amounts to 20 billion rubles, which is about 6% of the cash in circulation. This means that many people get their salaries late. Another reason behind this trend towards independent currencies, is that the other republics are suffering from monetary policies, being most loose in Russia. There is a general perception that prices are higher and have been higher in Russia in the free market, and that there is too great an abundance of rubles in Russia, which as far as I can see, is correct.

This is a crucial problem that has to be treated this year. A particular concern too, is the interrepublican trade. I presume that unfortunately we will see something similar as we saw when the CMEA trading system collapsed. Trade is likely to disappear, not only because it is becoming unprofitable and doesn't suit the new price structure, but because there is a shortage of liquidity for trade between the different republics. I think that there are strong arguments in favor of some kind of payments union, as Oli Havrylyshyn and John Williamson have argued in a recent paper. But frankly, I am very pessimistic about the possibilities of bringing this about. I think that we are likely to see a tremendous decline in the amount of trade between the republics and in particular with the central Asians. They will be very badly hit and probably the proud European republics, like the Baltic republics, Belarus and Ukraine, will find that their adjustment will be much harder than expected. Something that concerns international economic agencies, is to train people for the central functions so that there are people who can run central banks, ministries of finance and other central authorities in these states. Because, I think that there is no doubt that they really will be independent.

**Abel Gezevich Aganbegyan**  
**Academy of National Economy - Moscow**

Generally, I agree with Prof. Aslund's view on the present situation in the Russian republic. I would like to concentrate for now on the current economic situation and the future for my republic and the Commonwealth. There is no question that we have a deep economic crisis. In January and February of 1992, our GDP in Russia decreased by 17% compared to 1989 statistics. This is not the low point of the crisis. We expect that the low point will occur sometime in 1983 and there will be a decrease in GDP of 25-30%. This may be an optimistic forecast.

We now have a very dangerous intermediate period. While we have destroyed the centralized system, we did not create a new market system. It is impossible and costly to remain in this intermediate stage for a long time because our economic relations within the Soviet Union are braking apart. There is no other alternative at this time but to move as quickly as possible to a free market system.

The transition to a market economy includes five main reform policies. First, stabilize macroeconomic policies (cut the budget deficit, stop credit emission, etc.). Secondly and thirdly, concentrate on small privatization and then liberalize the prices. The fourth step is to implement special policies of the state to provide support for some welfare departments and the energy industry, and possibly railroads and the conversion process from military to civilian production. Lastly, it is essential to integrate our economy into the world market.

It would have been better to have begun our reform with privatization and a stable macroeconomic policy. But this was impossible. With our new government created, we had no time to wait. We could not delay liberalization of prices because our collective farms and agricultural enterprises would not sell their goods until price liberalization occurred. We had a very serious situation, and I believe that our government, in this situation, took the right steps. They began shock therapy and immediately liberalized prices before privatization. In my opinion, theoretically, this is the wrong process, but in reality, we had no other choice. We did not have the opportunity to implement a less painful price liberalization policy. In correlation with the liberalization of prices, our government tightened credit emissions and established a new tax system. Credit has been progressively tightened with increased rates of interest nearing 40-50% a year.

Next, the government developed policies for privatization, but this is a very slow process. We are beginning privatization and land reform. The liberalization of prices, based on state shops, a state retail trade system, with monopolies for producing and trade, it is a very dangerous process. In the beginning, we saw some chaos in our price policy, including corruption and disintegration of links.

In correlation to price liberalization, the government continues to cut the budget deficit and tighten credit emission. I believe that with the step by step process, the situation is normalizing. But I expect the situation will become worse before it gets better. We have no hyperinflation as some people expected, and we are slowly creating a market for industrial and agricultural products. Firms face difficulties in paying wages; many enterprises now have no money to pay for supply materials and therefore they are cutting production. At the end of February, price stabilization had not yet been achieved, but prices for some products have actually decreased. For example, there are improvements in the rate of exchange between the ruble and dollars. The maximum was \$1=230 R (rubles) in our official auction. In the last official auction, it was \$1=139 R. We also have another

rate of exchange for cash because our government established a limit for cash transactions. The maximum rate of exchange for cash was \$1=117 R, the latest cash rate is \$1=70 R. A lot of people now want to exchange dollars for rubles because the price in rubles is less than the price in dollars on our internal markets. As you are aware, we also have special shops called "beriozka" for hard currency.

Every week our center of study of public opinion studies what people feel about this situation. According to the last report, we have some optimistic signs. It appears that a section of our population thinks that it has begun to see the light at the end of the tunnel. It is very early to talk about the success of our reform because it is only in the early stages. But the early results appear to be better than expected.

You know that the author of this economic reform, Yegor Gaidar, was nominated as First Prime Minister of Government, in the Russian Federation. He was the Director of the Institute for Economic Policy under our Academy of National Economy. I invited him as a director two years ago and he then created a new research institute and invited sixty-two intelligent, young researchers. They forecasted what would happen if the policies were implemented. It is interesting how accurate those forecasts have been since implementation.

It is very important to note that our government in the economic field is based on Gaidar's team. One is his Deputy Director of the Institute and one is the Minister of Economics, Andrei Nechayev. And another Deputy, Mashitz, is Minister of Relations with our former Republics. One previous Chief of Laboratories is now the Minister responsible for Privatization, Anatoli Chubaes. Another Chief of Laboratory, is a Minister of Natural Resources and Environment. Another is the Minister of Foreign Investment, Leonid Grigorev. Twenty people from the institute are now included in the new Russian government.

What do we expect? We expect that April and May will be a more difficult time because we expect a fast reduction in the level of restrictive policy and restructuring. For example, the production of agricultural machinery tools decreased twice, we expect another similar decrease during the next two months. This will increase unemployment in our country. We expect declines, especially in metallurgy and machinery because our investment will near zero.

At the end of April, our government wants to increase the price of oil, fuel and energy. You know that our internal price of oil is very low. One barrel is about 50 R, less than \$1 in exchange rate -- 50 cents. We expect that the price of oil will multiply five to seven times. In addition to oil, several other products will be included in price liberalization and this will result in a new shock for the economy.

We also have a lot of difficulties in the agricultural sector. Soon we will begin the new fiscal agricultural year without any substantial agricultural economic reforms. We have only proposed land reform, but there has been no implementation. I forecast that the value of agricultural production will decrease this year. And next winter, the food supply situation will be worse than this winter. But I hope that next winter will be the last winter with these results.

A few days ago, we had a discussion within our government about what reforms can be implemented before the next agricultural year. We worked out some measures which will hopefully reduce some of the shock to the economy. In general, we have a second area of difficulties in the

future: hyperinflation and hyper-unemployment. But our government presently has a plan to bypass these two serious difficulties.

In my opinion, the economic policy of our new government generally has been a success thus far. However it does have its drawbacks. First, the government has been late in implementing policies for small privatization, land reform and housing privatization. Privatization is a key problem in the future. Without privatization reforms, the transfer to a market economy will be impossible. Our government understands the importance of privatization reforms but has not made it a top priority yet. Secondly, I think that price reform must be prepared better. Our economic reform is not only an economic problem or a management problem, it is a political problem because we have a serious disintegration within the Commonwealth. More must be done to save this problem. You know that before, in the former Soviet Union, we had an interstate economic committee headed by Ivan Silaev and Gregori Yavlinsky. They worked closely with representatives of all the republics and prepared about twenty concrete economic agreements between the republics. These agreements dealt with regulation of prices, budget, creation of a new banking system, custom tariff, and tax policy. And it is surprising to me why the new government has not used these past agreements for implementation.

Yesterday I was in a meeting with representatives of the Russian commodity exchange, headed by Mr. Borovoy. At the meeting were entrepreneurs from the republics, presidents of commercial banks, presidents of private enterprises, etc. There were about one hundred key people from our entrepreneur group at the meeting. They were very angry because the government had not created and implemented the necessary conditions and policies for the entrepreneurs. I think this is a very serious problem.

My last comments concern the political stability within the CIS. The Commonwealth appears to be disintegrating along with the essential economic relations within the republic network. This is dangerous because economic integration is very important between our republics. I believe the economic integration between the republics is more interrelated than the economic ties of the European Common Market. For example, France, Germany, or Great Britain have over fifty percent of their foreign trade outside of the Common Market. Ukraine's foreign trade is 90% with other former Soviet republics and only 10% is with western countries. This is a high degree of trade interdependence. The present disintegration of relations between the CIS is very painful, however it will be disastrous if the relations are destroyed. However there are some positive signs. In the last meeting of CIS' Presidents in Minsk, they created an intercountry management organization for railroads and energy because they realized how important it was to pursue coordinating economic policies for railroads and energy.

As time passes, the Commonwealth leaders will understand that it is impossible to have a common market without a unified finance policy, banking system, custom policy, and currency policy. Eventually, I think a new union will be created, not a totalitarian system or a centralized administrative system, but a strong and united economic market, like the Common Market in Europe.

For our future, I am an optimist. But you know we have a new definition of who is an optimist and who is a pessimist. A pessimist thinks that it is impossible for the current economic situation to be worse, but an optimist knows that things could be worse.

**George Soros**  
**Soros Management Fund**

I should tell you right up front that my view of the situation in the former Soviet Union is not just grim, but cataclysmic. We are witnessing the collapse of a totalitarian system which was more thoroughgoing than any other. We may therefore be facing an event that is unprecedented in history. I think the collapse may be practically bottomless unless something is done to arrest it. Only active intervention from the outside can prevent a cataclysm.

This is not a view that I adopted recently. I held it since 1988, when I first organized a task force to try to create an open sector in the Soviet economy. I realized then that the command system was no longer intact, that it was disintegrating.

To understand the revolution which is currently unfolding in the Soviet Union, we need a different conceptual framework than the one we are used to. As economist, we base our thinking on the concept of equilibrium and we like to rely on theories that are considered to be timelessly valid. In this instance, however, we are dealing with a process which is fundamentally time-bound and very far from equilibrium.

In chaos theory there is a concept of "far-from-equilibrium conditions" which is quite useful in understanding both the Soviet system as it existed until recently and its present disintegration. The Soviet system was extremely rigid and unchanging, yet there was a wide gap between prevailing dogma and the actual state of affairs. Due to its rigidity, the system could not be reformed. The attempt at reform precipitated a process of disintegration. As the ruling authority lacked the ability to manage change, events literally spun out of control. And as the process accelerated, the pace of events exceeded people's ability to adjust to them. It seemed to me back in 1988 that a revolution was in store. Events since then have borne out my expectations.

The revolution inside the Soviet Union is fundamentally different from that which occurred in Eastern Europe in 1989. In the case of Eastern Europe, the collapse of the old system meant the birth of a new one. What made the transition so extraordinary was that the established authority renounced power so willingly. It is unprecedented that a bureaucracy as entrenched as the Communist apparat should simply lay down and play dead. Yet, that is precisely what happened in the case of Czechoslovakia. In Romania, the transition was more bloody and less complete. Taking Eastern Europe as a whole, the collapse of communism marked the rebirth of democracy and market economy.

Not so in the Soviet Union. The old guard was offered an opportunity to relinquish power in the form of the Shatalin plan, but it refused the offer. The political conception behind the Shatalin plan was to create a new central authority, namely the Interrepublican Council, which was to gain popular support by doing battle with existing central authority. Unfortunately, President Gorbachev refused to endorse the Shatalin plan and, in so doing, sealed his own fate as well as that of the Soviet Union.

I have developed a conceptual framework in terms of which, the rise and fall of the Soviet Union can be understood. I won't try to explain it in five minutes, you have to read my book, Underwriting Democracy (The Free Press, 1991), where it is hidden in the third part so as not to frighten the reader. Just to give you a taste of it, I see a similarity between the disintegration of the

Soviet Union and the boom-bust process which we can observe from time to time in the stock market. Unlike *Black Monday*, the bust occurs not over the course of one day but several months.

We are currently witnessing a bust. In financial markets, a dramatic bust is usually followed by a much slower process of recovery. That is what happened in Eastern Europe. But in the case of the Soviet Union, the bust is not followed by a reversal. We are more likely to witness a continuation. One bust will be followed by another. In stock market terms, this is called a cascade or a waterfall. You have a sharp break, then some attempt to consolidate, then another break because the attempt to reverse the trend has failed. It is difficult to tell how far the process will go. Certainly, Yugoslavia comes to mind, and the analogy is far too close for comfort. But I think Zaire may be a better analogy, where troops went on a rampage because they were not getting paid.

How fast will we get there? Since we are in the climatic phase of the boom-bust process, in theory it ought to be extremely fast. In practice, there is a lot of inertia. When I go to Moscow, for instance, I don't notice all that much change. If you look at the food situation, there is no food in the shops, but if you go into people's homes, they eat quite well. People benefit from all kinds of non-formal arrangements which keep them going. Of course there are people who are not connected to this informal system, such as the old-age pensioners, who are really starving.

Similarly in agriculture, I would have thought that with the dislocations there would be no sowing in April, and several people have told me that there would be no harvest. But a friend of mine, Theodore Shanin, Professor of Sociology at the University of Manchester, has a team in the field and reports that the situation is not so grave. Production may drop a little bit more than it did last year, but there will still be a harvest. So it is very difficult for me to say how long it will take to reach total collapse. There may be more time in practice than one would expect from the theory.

The process of disintegration received a very sharp additional impulse from the breakdown of interstate trade. This breakdown is very real and its impact will be significantly larger than the breakdown of COMECON, because the volume of trade among the former republics far exceeds trade between Eastern Europe and the former Soviet Union. You can really see the shortages hitting. For instance, Ukraine is not getting much oil, timber, or paper from Russia.

Interstate trade is based on bilateral trade agreements which were concluded at the end of 1991. These are barter agreements which call for quantities of commodities to be exchanged without specifying prices. But Russia went off the state order system, and therefore is not fulfilling these contracts. There was a discussion in the Gaidar government whether to impose state orders in order to fulfill these agreements, but they decided against it.

Actually, Russia is least affected by the breakdown because it is the largest unit. Nevertheless, you see shortages there. Just to give you one example, the best selling item in the Arbat is used light bulbs, which people are buying in order to take to their offices in order to exchange them for working light bulbs. There is no production of light bulbs presumably because some vital part is coming from outside.

The key question is: can this process of deterioration be arrested before it has run its course? I believe it can, because there can be a change in trend whenever a number of factors have come together, the most important of which is foreign assistance, particularly in the area of monetary

stabilization. By definition, the process of deterioration will have run its course whenever there is a change in trend.

Actually, we are at a moment right now where the trend could turn around. The chances are better right now than a few months before, and are probably also better than a few months from now. I entirely agree with what Jeff Sachs said last night, the trouble is that he would have said the same thing six months ago, and at that time I did not think it was appropriate. I did not agree with the Grand Bargain. I thought the chance to preserve the Union was lost already, and that the Grand Bargain was a hopeless endeavor. Mr. Yavlinsky, a man I greatly admire, failed to move with the times and recognize that the Soviet Union could not be held together.

Today however, Russia is a new political entity led by a president who enjoys a considerable personal following. Deputy Prime Minister Gaidar is genuinely, and radically, devoted to creating a new economic system. His focus on monetary stabilization is appropriate because if there is going to be a viable new system, it must be a monetary system. There must be a store of value and a medium of exchange to allow people to produce, buy, and sell. There is simply no other basis for a new system. Fortunately, this point is recognized by Mr. Gaidar.

This creates a very favorable political constellation in Russia. The government is composed of a cadre of like-minded people -- a young, honest team that works well together and is learning fast on the job. Moreover, it has the backing of Mr. Yeltsin who took on the job of prime minister and accepted direct personal responsibility for the economic reform. But, unfortunately, all this is not enough.

Gaidar himself knew that he was embarking on an impossible mission. He has a vision of himself as some kind of *Kamikaze* pilot and in fact he is encountering insurmountable political resistance. An anti-reform movement gathers strength from the hardships imposed by the reforms. It is coalescing around people like Zhirinovskiy and Aksnis, a sort of fascist, nationalist grouping that draws its strength from disenfranchised apparatchiks.

At the same time, the supporters of reform are increasingly divided. The military-industrial complex finds the reforms too radical, while the radicals in Parliament oppose it because the Supreme Soviet has been deprived of power. So Gaidar does not control the Supreme Soviet. He cannot easily pass legislation. He can only rule by the executive powers that were conferred on President Yeltsin. But at the April meeting of the Supreme Soviet, there will be an attempt to withdraw these powers, and it will be difficult to resist it. So he needs reinforcement and, as I said earlier, it has to come from abroad in the form of a stabilization program.

Unfortunately, this will take time to put together. With the best will in the world, it cannot be ready in time. The danger is that by the time it is ready, if indeed it ever will be, the window of opportunity may be closed. That is why Gaidar has been pleading for at least a promise or an indication that a request for a stabilization fund will be favorably considered.

What is needed, quite clearly, is a program sponsored by the International Monetary Fund (IMF). Yet, a traditional IMF program would not be enough in this case. It would take the form of a letter of intent with conditions attached. If the conditions are not met, the monies would not be disbursed. Given the present chaotic state of affairs, most likely the conditions would not be fulfilled.

Therefore, in addition to the IMF program, Russia and even more, the other newly formed states, need the assistance of some kind of international civil service -- foreign experts working inside the government performing certain tasks that they cannot perform themselves, particularly in the area of money, banking and foreign exchange controls. To give an example: the Gaidar government imposed export taxes as a way of raising revenue. This was first done in dollars, but the exporters had no dollars. The taxes were changed to rubles and the Central Bank was willing to extend credit to the exporters enabling them to export first and pay afterwards. The export taxes were meant to service Russia's debt obligations, but the Minister of Finance refused to segregate the funds. Therefore, the Central Bank refused to open the credit account. As a result, exports came to a practical standstill for an extended period. This was due to a technical inability to operate exchange controls.

I must say that it is pathetic to see how Western assistance plays itself out. Some experts, such as Anders Aslund and Jeffrey Sachs, provide effective advice and are very much appreciated, but they come as volunteers. The government is not in a position to engage its own experts. They would like to have Paul Volcker come and help them run their Central Bank, and he would be willing to volunteer some to his own time. But he would need a team, and the team would need to be paid, not by a funding agency but by the Russian government. Yet no funding agency is willing to give the Russian government the money. Funding agencies insist on retaining control over the selection of experts, yet for these experts to be effective, they must be chosen by, and responsible to, the Russian government. For whatever reason, nobody has understood this point and seen it worthwhile to provide them with a relatively small amount of money. About \$100 million would buy 500 experts at \$200,000 each. This would make a tremendous difference.

I have attempted to do this on a small scale in Ukraine. With the failure of the Shatalin plan, I recognized that there was going to be a Ukraine and I considered it essential to give Ukraine the ability to function as a state. I financed a Council of Advisors and we now have four people actually working there. Oli Havrylyshyn of the World Bank is one of them; a banker from the Bank of Boston is another, and there are two other people. It is amazing just how much they can do. They have gained the confidence of the people they work with, and as a way of providing assistance, it is very effective.

My intention, in fact, was to create a prototype of Western assistance. Obviously, I cannot do it on a scale which it is needed, and I am really disappointed that nobody has followed my example. I would commend it to your attention because you may be in a position to do something about it.

As an institution, the World Bank is ill-suited to deal with a rapidly changing, revolutionary situation because its reaction time is too slow. Nevertheless, I think that agriculture is one field where the World Bank is well qualified to be effective because of its authority. I believe there is a good chance of implementing a World Bank program because legislators in the former Soviet Union would listen to the World Bank. The World Bank does not realize the respect it enjoys there.

Another major area the World Bank should address is interstate trade and payment. We organized a conference in Brussels on a payments union, with several states represented. We then convened a follow-up meeting in February on interstate trade. It became clear to me at that meeting

that there is a concrete opportunity to establish a trading system between the Baltic states and Russia based not on state orders, but on market principles.

Using market prices would create a very serious balance of payments problem for the Baltic states because the terms of trade would shift very severely against them. They would need a Structural Adjustment Loan. The size of the problem is not unmanageable because the Baltic states are quite small. The World Bank and the European Community could combine forces because the European Community has a political commitment to the Baltic states. The demonstration effect of interstate trade moving to world market prices with the help of Western assistance would be tremendous. This is a concrete project that could be implemented relatively fast. It would have to be initiated from the World Bank or the European Community because I am afraid that the Baltic prime ministers are not thinking in these terms. They are only thinking of their own countries and are not even aware that a regional scheme could effect international support. Though it would take some time to prepare, it is something that could be started right now, even before the membership process has been completed. I believe it could make a real difference. It may be the project that sets in motion a change in trend. Thank you very much.

**Norbert Walter**  
**Deutsche Bank**

Ladies and gentlemen, since we are addressing the former Soviet Union, but have concentrated so heavily on Russia, I might start by remarking on implications that may have to do with simply that. If we in the West choose Russia as the candidate for our consideration and help, this might have political implications for what was formerly the Soviet Union. It might end up being a provocation of the other republics. For while I do understand that we feel that it is very important, much more important, to help Russia and to ask Russia to avoid nuclear proliferation and other threats to the world economy, at the same time, this has a trade off. At times it seems as if Russia behaves not just as the most important republic in a constructive way, in what is now the CIS, but acts like an imperialistic republic in that area. But even if this were not the case, it is perceived by many of the Republics as being imperialistic, and this has a bearing. I believe in many cases we overlook that very effect.

Last evening's presentation by Jeff Sachs indicated that he and many others believe that we are in a Catch-22 situation, and waiting for the other side to act, may make things worse in the end. In a broad sense this is true; on the other hand it is quite obvious that much of the advice he was offering, and others were offering, only can work and does work in systems that are in a sense stable and established. *Mr. Sachs' particular emphasis on macro economic stabilization, I think, misses the important point of the non-existence of credibility of perspective, of an established legal system.* There is obviously a kind of consensus that we have to think of the sequencing of reform steps. Since I established a new firm in Deutsche Bank, as of January this year, when we moved from zero pricing to a kind of guessing equilibrium prices, I have seen in a small group of 200 people that you put everything into chaos if you move from being a mere budget item to something like a fully fee-based, private institution. We are just 200 people in a very well-organized country in a well-organized firm. We know every day that whatever we do first, we will be blamed for the next day; that we have chosen the wrong thing to do first. We try again to adjust, and we of course please some but harm many others. This situation will prevail in what was formerly the Soviet Union, because it is quite obvious that they have to do even more things at the same time.

It is quite obvious that price reform is an important step in demonopolization. I believe opening to international competition is also an important point. On the other hand, we fear that if we do this too fast, we will create a problem. We know that establishing a tax system is very important. *If there is no tax system in place and we cannot ask the state to do anything, we cannot talk about monetary stabilization,* because the printing of money is the only means to pay for something under certain circumstances.

If you are talking about *monetary stabilization*, seminar-type, discussions on whether we should have a K-money rule or whether we should aim at a certain real rate of interest are interesting, but most probably meaningless. Even with very thorough surveys, you just don't have the statistics necessary to do it. Another example we are running into, which is a minimal experiment compared to what we are in for in the former Soviet Union, is German unification and the extension of the currency area of the DM. We really didn't know the liquidity preference of the East Germans; and therefore of course, we wouldn't know what addition to the money supply was appropriate. We did not know what would be deflationary or inflationary. The market has very clear-cut perceptions, which were wrong, because the financial markets are dominated by London and New York. While not exactly close to East Berlin, they dominate the financial markets and therefore the consequences worldwide and for Germany, were from the perception on the issue. I do believe that *monetary*

*stabilization is best approached for regions like Eastern Europe and the Soviet Union, if you have an exchange rate anchor.* I think that all the other alternatives are less attractive.

Here of course we have again a complication now that creating money at the republican level is not only a threat, but a reality. *Of course we know that all those macro steps are not very meaningful if we don't do something at the micro level. What I mean is establishing property rights, privatization, trade policy -- having a regime for trade policy for both the inter-republican and the international relationship.* If I then listen to people who are advocating separate currencies for separate republics, and talking about free intra-commonwealth trade in the former Soviet Union, I would like to point out to them that, if a republic aims at having its own currency, this is just a corollary of pursuing independent trade policies. In all practical cases, individual currencies came along with protectionist trade policies and that is something we should not forget.

We already heard about the War of Laws, the question of who is setting the rules. We always, all of us, the Soviet people, the western investors, the western experts, have to guess who governs. We don't know today what will be the system of tomorrow. *We don't have a legal system in place.* We have not even begun to talk about courts to help control the executive branch, and we have not talked about whether the constitutional court, approved in the constitution and in the process of being established, is being adhered to. We don't have enforceable titles; we often don't know whether the contracting party is legally entitled to be the contracting party. We have not talked much about democratic structures in the former Soviet Union, which are, I believe, quite important in terms of the durability of a certain system.

Of course we all know that the democratic structures are not helping to speed up processes, and since time is so important, elitist intellectuals are tempted not only to ignore democratic structures, but even to prevent such structures because they are an obstacle to general improvement. That is something that we at least should understand, be aware of, and openly discuss.

Then there is the very fact that if we support the former Soviet Union, this has implications for the rest of the world, which, for good reason, is expecting help from the west as well. We should be very aware of the moral hazard in offering the former Soviet Union help that is not as conditioned as it is for other countries. There is something else, and again the small experiment we made in Germany is very enlightening and very helpful to understand processes. Jeff Sachs last night addressed the wrong audience. Jeff has to address the electorate in western countries because he is arguing to spend the electorate's money. He has not convinced the electorate because he leaves that to the politicians. But that is not how our democracies function. We have to find somebody who can explain and convince in the end our democratic societies to shoulder a bigger burden -- be it in the form of higher taxes, in the form of working harder or in the form of higher interest rates. There are no alternatives but to convince the electorate and to convince business to become active in Eastern Europe and the former Soviet Union.

Of course the economist always has to *ask whether money is being spent in the most productive way.* Here we use as a proxy, in the case of the former Soviet Union, that if we do not help the former Soviet Union, this would imply the greatest threat to the world. This very fact however has to be explained. It is quite obvious that we in the west must convince our electorate and our business that the judgement of the threat in the former Soviet Union is appropriately and realistically assessed. There are no usable, domestic resources that could be used first in the former

Soviet Union. I just had a chance last autumn to look into the assessment of Soviet analysts on production, particularly energy production, and exports. I was handed over information that I gave back with the remark that they might want to look again at it, because the information implied that the energy intensity of Soviet production has increased by something like 20%. This is rubbish. It is absolutely impossible. It's impossible that with rising energy prices such a thing would happen. The opposite holds true, and it's quite obvious that some of the leakages of pipelines were not real leakages but leakages in terms of not repatriating the money for exported energy.

This is something that is quite obvious. I don't blame those people who believe that there is political chaos, that they take care that their money is stored in a safe place, but we should again understand that this is not convincing for the international audience, for the international institutions, for the international banking community, that should help on the basis of such information.

On the second issue, of course whether there is this great threat in the former Soviet Union, is the judgement on the level of pain that is acceptable in the former Soviet Union. What we need is a dynamic, multi-stage analysis that shows the productiveness of capital that is spent in what was formerly the Soviet Union.

From the past behavior, we see that the help for eastern Europe and the former Soviet Union was following certain patterns. It was quite obvious that countries, that governments, had differently perceived self interests. Obviously, the strongest incentive to help was found in Germany, for obvious reasons: to achieve unification, to avoid a massive migration out of the former Soviet Union, and to possibly make use of future trade ties to the potentially important area. It is quite obvious that any future attempts have to again be based on such considerations. As to the question of conditional help, I'm coming back to the issue I already dealt with -- namely whether this is enforceable. I have quite some doubt that much of the help we have thought of, if indeed conditioned, could be enforced.

Of course we have to consider the national governments' interests and their capabilities. At this moment in time, it seems as if the German government claims to have run out of resources.

There is something else: I believe national governments have a certain limitation in helping the former Soviet Union and Russia. This has to do with historical heritage. It is quite difficult for Germany to condition help, in a very strict form, since it was the Soviet Union's enemy only 50 years ago. Therefore it is quite obvious that for conditioned help, it is much more appropriate to ask international organizations to offer their services. And here, I believe, comes the particular strength of international organizations, of course in addition to their expertise in certain fields.

*What we are out for is not a modification of a system in a country, but what we are out for here is the rebuilding of a continent.* And here I believe we have to stress much more western support in developing new institutions. We did not address a number of issues that were crucial. We did not help to develop political parties in the republics of the former Soviet Union, and I believe a lot could be learned from the varied experiences of different western countries. We didn't help in developing a constitution; we didn't help in setting a legislative power, an administration, and more important possibly, a court system.

We have not helped to discuss what should be the legal hierarchy in the new Commonwealth of Independent States, for the questions of military, trade policy, environment, and the currency

system. We have been a cacophony of opinions, and we are not really stressing these very important and basic points. Only after we have solved those basic issues of legal structures can the experts on certain technical issues come and be helpful. Experts for setting up a tax system, for setting up a two-tiered banking sector, for developing regulatory authorities, regulatory bodies. (For example, insurance and banking supervision. For example, norms, standards, and things like that.)

After we have solved these basic legal and technical problems, we can help in setting up structures at the firm level. Here again we normally talk about money and about programs -- that is inappropriate. Again I might cite a little example, that of my bank and its activity in the banking system of our neighboring, new federal states for 16 million people, where we have a market share of 5-10%. My bank, with about 60,000 staff, added 10,000 more. Out of those, 8,000 were East Germans who had practically no understanding of banking whatsoever; they were just collecting deposits before. We added 1,000 experienced West German managers to the 200 branches we had opened in East Germany. They had to develop products and, at the same time, educate the people over there. The West German bank, in turn, took on something like 700-1,000 East Germans for training in West German branches. This is only one bank helping to set up a banking system in East Germany via managerial transfer. We have not been entirely successful in that effort. Our competitor, Dresdner Bank has a ratio of East German staff and West German staff of 1:3. They were much better at setting up western-quality banking within the appropriate time frame. We overburdened our 1,000 managers by doing just what I described. This gives you an idea of what we have to resolve further east.

I think that this is again not considered appropriate, and it is not only help in terms of skills like banking that weren't even developed. There are no peasants who would come back even if there is private land ownership. Even in East Germany we learned that it was not really possible to get back -- the agricultural workers to own their own farms. But thank God we had Dutch farmers who were prepared to take over, who offered their entrepreneurial skills to East Germany to make the agricultural sector in East Germany productive.

These are models that we have to consider and that we can learn from. In some cases, there will not be a sufficient answer. But this is the approach we have to take. - Private ownership is needed but also help with managerial skills and marketing orientation. They need accountants with the necessary skills, in the necessary numbers in those countries. If we want to wait until the educational process has taken care of the problem, it will take too long. We have to import hundreds of thousands of experts to do the job. Since we cannot do everything at the same time, we probably have to start with regions of the former Soviet Union. We possibly have to start with certain republics or even within republics. We have to start with something like a free-trade zone that, once developed, can serve as a model for the rest.

It's quite obvious that whatever we do, we will be blamed for making mistakes. Therefore, I might mention a few things we possibly should consider as essentials. The first is to stop starvation. The question is whether the stopping of starvation is indeed a possibility. I understood last night that Jeff is not exactly happy with the kind, socialist approach or the Christian approach to food-help to the former Soviet Union -- the giveaway help that the west has been engaging in. As long as structures for distribution and markets do not exist, even a strong, ardent defender of the market system, as I am, would suggest that we cannot possibly send big money and hope that starvation is being avoided in an optimal way.

The second, very important issue is to avoid selling stocks of weaponry. I have to admit, that this is very important, but I am not an expert and do not know the answers to that question.

The third point is institution-building. For legal structures to be stabilized, help is needed at the micro-entrepreneurial level. Here I believe a need for government guarantees exists and direct support has to be given. We have to be careful that the money that is being made out of those guarantees, does not go to consultants. That makes the consultants rich, rather than helping the former Soviet Union and its republics. We have to think much more carefully about the cost effectiveness of help. In most cases, the cost effectiveness of help is much better achieved by helping on the spot. I hate the visitors programs for Soviet people coming to expensive western hotels for two-weeks or two-day conferences, and then travelling back. Instead, there are much more cost-efficient ways to support and to create expertise for these people.

I wouldn't know whether it is crazy, but I will try to throw out a crazy idea. I do believe that since our armies are underemployed these days, institutions like the Red Army and the Pentagon are in a very good position indeed to select military people that are qualified, for example, to set up the distribution system or to set up a crude telecommunication system together with a large number of experts from the private sector in logistics or telecommunications. Those people could help to build up the infrastructure in those fields in the former Soviet Union. Here I believe we could indeed make use of the American preparedness to help *with people, rather than with money. Here technical help could indeed be used in a very productive way.* I just mentioned that it is most probably not cost effective if you asked Soviet experts to come to western hotels. But we should help to set up TV education programs in the former Soviet Union and we could set up examinations at the end of such education programs via TV.

Jeff mentioned last night that it is essential to keep imports flowing. Here comes the delicate part, because again, we have to ask whether this is done by grants or by credits from outside. We still have to ask why the Soviet people do not use their property or stocks, for example, of energy, to maintain import flows. It is quite obvious that last year Hungary increased its exports to the West by more than a third. This of course has to do with the fact that Hungary behaved in a certain way and received support from outside -- direct investment, loans. It is of course something that we have to consider, if we now grant the former Soviet Union help, whereas Hungary had to take care of itself. How would this influence efforts in other east European countries.

What is the role of western governments? Must the United States take the lead? Let me be a little bit aggressive. If the lead is to be taken by somebody who asks to be repaid 150% for its effort, as in the Gulf crisis, the world community would not accept that leadership easily. So if the United States, takes the lead and determines the form of help for eastern Europe and the former Soviet Union, then it has to support at least by its trade weight, if not by its GNP weight. What has happened recently is quite obvious: this country is not even ready to increase the quota for the IMF. This is inappropriate and certainly has to be changed.

Germany's role is obvious. But its role over the last 3-4 years, having given 50 or more percent of the help for the former Soviet Union, after the cost of unification, is not acceptable. But certainly Germany would remain the second most important partner for help for eastern Europe and the former Soviet Union, even after the burden of the unification. Japan so far, has not taken a very constructive role. It has, more or less, taken a wait and see position. It seems as if the Japanese

investors are waiting for the former Soviet Union to become cheaper in the future. There is a constructive role for the French and English in a number of cases, and I think they indeed have to contribute, for example, to the European Bank for Reconstruction and Development or the help of the Bank of England for the setting up of the central bank system in the former Soviet Union.

The banks have to consider their role as well. It's quite obvious that if we help Poland, this has a bearing on Bulgaria, and what we do for the former Soviet Union will have an impact on expectations of other indebted countries in the east. It's quite obvious that the banks should not be given an incentive to cheat. The requests for continuation of interest payments is a principal question and has to do with the declaration of default if otherwise. So, what we see is, in the future, most probably fresh money in order to take care that the interest payments can be made in the formal sense. But beyond that, if there is no more progress in terms of reform programs and correction of policies, then fresh money will be rather scarce.

It's quite difficult to give fresh money to a region when it has to be depreciated by 90% at the very moment it is issued. As you may imagine, that is quite difficult to explain to the savers or to your shareholders.

To sum up, it is obvious that the role of foreign aid is essential. It's self-help for the west. First we establish the western system and by doing so make the world a better place. Second, we avoid nuclear weapons proliferation. Third, we avoid massive migration. Fourth, we avoid a military coup. Foreign aid will help to speed up the reform. It is essential to set up the legal system, democratic institutions and the market system. We have to set into motion an eastward migration of experts. We have to allow essential imports to continue to flow in order to avoid starvation. We have to enhance competition and competitiveness by opening up the east. We have to set in place a financial system.

After that we have to establish help for the macro-stabilization that was talked about so much last night. The finance will come and has to come from international organizations and we should not only think of the World Bank, IMF and EBRD. We should possibly establish something in the former Soviet Union, in the republics of the former Soviet Union, that is comparable to the Bank of Reconstruction and Development in Germany (the KfW) which helped to set up small and medium-sized businesses. Of course governments have to come in and private banks as well.

The stabilization fund we had talked about last night is, I think more, a final step to this architecture than its beginning. Thank you all for your attention.

**Richard Pipes**  
**Harvard University**

Well, I am not a banker, I am not even an economist. It would be presumptuous on my part to express opinions on the subjects which have been discussed yesterday and today, although I do have some views on them. I am a historian with some governmental experience. What I would like to talk about is the historical legacy which underpins the present crisis.

As you know, history operates on different time schedules. Certain things happen rapidly and can be explained in such terms: for example, the clock moves in seconds. Other phenomena take place at a slower pace and they are measured in minutes and hours, there are still others which are defined at even slower rates.

Now some of the problems which we have already discussed, such as emergency food, can obviously be solved rapidly -- if the will is there. The stabilization of the Russian currency would take longer, but it can also foreseeably be done in rapid terms. But there are other problems which stem from what may broadly be called the political and economic culture, which are the legacy of the last centuries and which cannot be fixed rapidly and which underpin the crisis. So that even if you were to stabilize the ruble, even if you were to inject the monies that Jeff Sachs proposed last night at dinner, even if you did all these things and you sent thousands of experts -- I think that problems would still remain.

The best proof of this is that some countries of eastern Europe, when they were freed from communism (particularly Czechoslovakia), managed to make a very rapid transition and are on their way to recovery. Other countries such as Poland and Hungary are moving a bit more slowly but are moving in that direction. Russia seems to be sunk in a kind of morass from which it is very difficult to get out. It is not only because it is so large or because its problems are more severe, or because it has suffered from communism longer than anybody else, but also because it has a certain historical legacy which communism reinforced.

Communism was not caused by Russian history, Russian history provided a very propitious soil for communism. Over the past 70 years communism has reinforced certain traditions in Russia which were on the way out before the revolution. The past, the 70 years before the revolution, Russia was modernizing and westernizing, but all this was swept aside at the time of the revolution. The Bolshevik revolution in 1917 and what followed, was a throwback to Russian middle ages, to the Muscovite period, to the pre-Petrine, pre-Peter the Great period.

Now, I would like to mention some of these factors because they play a very profound role in today's crisis. The first of these is the fact that Russia traditionally has had an autocratic system of government. Russia had a parliament for 10 years before the revolution but it was a short lived institution that was sabotaged in many ways, both by radicals of the left and by the bureaucracy. The tradition of Russia is one of an autocratic government; a strong, effective government. Also, in Russian tradition, I mean a folk tradition, a good government was not necessarily one which was benign but one which was strong, effective. We all know the name Ivan the Terrible. In Russian, Ivan the Terrible is Ivan Groznii. Groznii does not mean terrible, it means awesome, and in Russian folklore he is not necessarily a bad tsar. He was a very strong tsar, a tsar that knew how to rule.

Another aspect to Russian autocratic tradition is that the Russian autocracy was a very peculiar kind. In sociological literature it was one that is known as a patrimonial monarchy. The

difference between the Russian autocracy in the 17th century and the absolute monarchies of western Europe, was that in western Europe there was a very strict division between the political powers and the rights to property of the sovereign, to those of the subject -- especially the subjects' rights to property. There were violations of this right, and there were rulers who did violate them, but they were considered tyrants, despots. In Russian tradition, all the property in the country belonged to the monarchy--all but small amounts of cash, clothing, and things like that sort. All the land, all the resources including all the people, all the subjects, belonged to the tsar. That meant that the tsar could exact service from all the subjects, including his nobility. Under tsarism, Russia really had no nobility because it had no corporate charters. It had a service class which owed life-long obligation to the monarchy. The idea that the government has to be strong and the idea that the government has to own everything, is very deeply rooted in the Russian, national psyche.

The concept of private property came into Russia very late, only 200 years ago with Catherine the Great. Further, there was no word for property in Russia, the term was introduced by Catherine the Great, she translated the German term *eigentum* into *sobstvyenost*. The concept of property has very shallow roots. Property in land was only introduced two centuries ago. Property in capital, associated with the idea of banks, only came in during the mid-19th century. There are no private banks in Russia before the middle of the 19th century, before the 1860s. So you have the tradition of a very strong monarchy, a very poorly developed sense of property, and of course, a very poorly developed sense of law. The absolute monarch was bound by nothing, neither by a written constitution nor by any public representative body. He could convene from time to time, and did convene from time to time, assemblies which advised him but which had no legislative authority.

Until 1861, the bulk of the Russian population was enserfed. Serfs were not slaves, they were attached to the land, they theoretically could not be sold apart from the land. They were not the property of the landowner, they were the property of the state and they were enserfed for the purpose of rendering a service to the service class: to enable it to render a service to the tsar. But even though they were not slaves, their status in many respects resembled that of slaves. They were not legal persons, a serf could not appear in court. They could not, after the reign of Catherine the Great, complain against their treatment by the landlords and technically speaking they owned no property. Land belonged to the landlord or to the state. Serfdom was very deeply embedded in the Russian psyche and it developed essential, anti-social habits of thought. That is, under serfdom, where a serf -- mind you, 90% of the Russian population was enserfed -- had no rights against his landlord or against a bureaucrat. The only thing he had was his wits, his cunning. Therefore, the way Russians defended themselves was by lying, by cheating, and so on and so forth. This was their natural defense against a very unjust system. Russian peasants, overwhelmingly both as serfs and after they were liberated, were not farmers in the western sense of the word, but were communal peasants. That is, they lived in communes.

Now, a commune was a very peculiar institution. A commune was known as a redistributational commune, in the sense that the households in the commune did not own the land on which they tilled. The land belonged to the commune. The commune periodically redistributed the land to its members, depending on the growth or decline of each household. Collectively, the commune was responsible for the payment of taxes. To ensure that taxes were paid, they had to make sure that all their members made enough money to pay the taxes. So they made sure that every household, depending on the number of adults it had, had enough land. Then every 7, 10, 15 years,

depending on the locality, they would take another census of the households and if the households shrank through death or migration, the land allotments would be reduced. If the household expanded, the land allotments would be proportionately increased. The land was held in strips, which were distributed throughout the village, ensuring everyone got land of the same quality and the same distance from the center of the village.

The peasant had no idea of ownership of the land. Land was only for use and he never accepted the notion of land ownership. He felt that land was created by God; just the way God created him, the air, the water, and you could use it. If you did use it, the product of it was your own but you had no title to it if you did not use it. In the 1860s, Tolstoy wrote rather prophetically that the revolution in Russia would not be about freedom, it would be about the protest of the ownership of land. And the first thing the peasants did in 1917 was to grab all the privately owned land and put it back in the commune for redistribution among themselves.

Here you have certain elements of tradition that now mitigate against the development of civic society and the development of democratic institutions. I may add one more factor; the part of the peasant culture. The peasant culture -- communal culture -- was highly egalitarian. The peasant would make sure that everybody would have the same amount of land. The psychology of the Russian communal peasant was: Better that everybody be poor than some of us be rich. It was always leveling but always leveling down, not up and that is of course absolutely imbedded in the psyche of the Russians today. Today, the vast majority of Russians, not to mention Russian leaders, are descendants of serfs. Overwhelmingly, the population has shifted from the village to the city. With rare exceptions, almost all the Russian leaders are descendants of serfs or of workers who were in turn, descendants of serfs.

One of the consequences of the Russian autocratic system is that it did not allow the formation -- until just before the revolution -- of private associations. In tsarist Russia, in the late 19th century, you could not have a trade union. You could not form political parties or any association other than those which were strictly professional. One consequence of this, that Russia always had, was very poorly developed lateral ties in the society. Society was to a very large extent atomized into communes, into worker associations, but you did not have really strong lateral ties creating a powerful society. The ties were all vertical and not horizontal. All power concentrated in the State and was directed by the State. This meant that whenever the State, in Russia, weakened or fell apart, as happened in Russian history three times -- once in the late 1630s, the 17th century, known as the Time of Troubles; then again in 1917 and again, now -- when this happens, society disintegrates and you have complete chaos. When the French revolution occurred in 1789, what you had was a change in government, a change in administration but you did not have a collapse of society. In Russia, whenever the government collapses, society collapses along with it -- and this is happening now. This is why it is so extremely difficult to rebuild Russian society. Russian society can only be rebuilt if there is a strong state and when a strong state is created, it makes absolutely certain that no society emerges.

The only group in Russia which has traditionally felt a kind of cohesion among itself was the intelligentsia. The intelligentsia always defined itself with its opposition to the state, it was the voice of a rather mute society. It was always very heroic, extremely brave, and it remained so even under the communists but it has always been incapable of doing anything positive. It has been very capable

of resisting but it cannot organize for action because again, like society at large, it is defined largely by resistance to the state. You see this lack of organized action today: when extremely courageous and intelligent people cannot get together and organize some sort of democratic party that can be effective. There are hundreds of individuals organizing followings among themselves but unable to unite for purposes of common action.

You know, the totalitarian system is supposed to create uniformity of thought but in actuality, it has created the very opposite. It did not allow an open exchange of opinions such as we have, it did not allow the creation of a consensus, ever. Every Russian has his own ideas of what needs to be done, and no two Russians can get together on the same means of achieving that objective. That is one of the great legacies of tsarism, but particularly of the Soviet system.

We all agree that what we are seeing now is anarchy and chaos. Is it all bad? I think it is not. I think that Russia now, for the first time in her history, has a chance to shed her traditions and cultures, and to build up a new society, a new state, from the bottom up. This would take a long time because history at this level moves very slowly. It may take Russians about a generation or two because you have to heal wounds inflicted on Russian society by centuries of her history. I think that it may come about. The alternative is dictatorship, it is what has happened before.

In the 17th century, during the Time of Troubles, an absolute monarchy was restored. In 1917, the Bolsheviks came to power. It should not to be excluded that this might happen again, that after a certain amount of anarchy -- which people find so intolerable -- that they will settle for another dictatorship; but I am moderately optimistic that this will not happen.

The country has been so traumatized for the past 75 years, that they are willing to try something new. Anywhere you go in Russia today, particularly at the economic level but also at the political level, you see signs, a certain maturing, a certain growth of independence. This is why I don't think we should be the "good uncle" who comes in there and helps them out too much. I think that they have to learn to do it themselves. We should do nothing *for* them, we should do anything possible to help them help themselves, but not do things for them. They have to learn to do for themselves. They will not lie down and die just because there is a shortage of food, they will manage. They will create a new economic system, but by themselves, first on a microeconomic level and then on the macro level.

That does not mean that we should not help them in stabilizing the ruble or not give them emergency food -- I'm all for that. I think on the whole, we should be very patient and allow society to disintegrate. Keep the distress at a moderate level and make it possible for Russia, for the first time in its history to develop a viable, society-based political and economic system. I think that this is happening. The chances are probably better than even that this will happen but it will take a long time. Most importantly it requires patience -- because you don't shed the legacy of centuries of history overnight.

**Dimitri Simes**  
**Carnegie Endowment for International Peace**

Let me make several brief observations. First, I think it is very important to know history. Second, it is also very important to be realistic about the meaning of history.

Nations, like people, are more predetermined. There are different sides to most of us. The environments in which we operate, circumstances under which we have to live have a profound impact on choices we make. Think about Oliver Cromwell, a country squire in his early forties, a fairly ordinary man. If there had been no great revolution in England, not only would we never have known him, we would never have known his capabilities.

Look at Mikhail Gorbachev, a man who was a career party aparatchik, there was nothing spectacular or remarkable about him. Look at Boris Yeltsin. I very carefully read the speeches he delivered in Sverdlovsk as party secretary, his speeches at party congresses before he came to Moscow, I talked to him on several occasions about his past, he did not know of what he was capable. I am not just saying that he was not aware of his anti-communist views, which he developed much later, I am saying that he was completely unaware of his capacity of becoming a leader of a revolution, a trouble-maker, an anti-establishment agitator.

Just as there are different sides to all of us, there are different sides to Russian history. One should always remember that.

At the time of the Magna Carta, there were two republics on the Russian territory: Novgorod and Pskov. These were two serious republics. Actually, it would be difficult to find the kinds of freedoms which were available in those two Russian republics, in most of the other states in Europe. If you go back to the 18th century you find that at the time of the French revolution, there were liberal Russian thinkers who were very close to the imperial court. Then of course in 1825, the Great December Revolt, which asked for a constitution and the emancipation of the serfs. And the reforms of Alexander II, the Tsar Liberator, in 1860: reforms which created an independent judiciary, reforms which allowed private property and rent, reforms which allowed some modicum of press freedom.

In the past, all these attempts to create an element of political and economic pluralism in Russia have failed. Was it bound to fail? This is a big question. I don't think that they were bound to fail because of some genetic code in Russia, I think that they were bound to fail because liberalism and the maintenance of an empire were inherently incompatible.

From the very beginning, the Russian state was an artificially built state -- from the top, through force and coercion, and without a strong sense of identity. It was very difficult for this kind of a state to liberalize and simultaneously stay together as it grew and eventually became a huge empire from the Baltic to the Pacific. Incidentally, that was one reason so many Sovietologists were wrong about the possibility of profound reform in the Soviet Union. We assumed that whoever came to power in the Soviet Union would have at the minimum, a survival instinct. That they would understand that if too much political freedom was allowed, if controls were relaxed to too great a degree, the empire would not survive. We thought that whoever came to power in Moscow, as long as he was a product of the communist party apparatus, we assumed that at a certain point this person would draw the line. But that did not happen.

It did not happen because we did not fully know the personality of Mikhail Gorbachev and that is a very important lesson. People sometimes start things which are much bigger than they ever expected them to be, they then have to deal with the unintended consequences of their reforms. To predict things like that, especially in a huge region called the former Soviet Union, with so many different players, with so many pressures -- both centrifugal and centripetal -- the ability to predict becomes impossible.

We do have to remember that one reason for optimism is that Russia is no longer an empire. That as long as they don't have to control reluctant people, they don't have to maintain a huge standing army intended to control them and threaten all their neighbors -- because once you have an army of this size, you can never be certain about your neighbors and your neighbors begin to organize against you. It is a vicious circle, a self-fulfilling prophecy, because when you threaten everyone, you are never secure.

Stripped to a more modest size, without its empire, Russia is in a much better position to reform itself than it has ever been in history. On the other hand, there is a problem. Societies are made of people and there is only a certain level of pain a people can absorb. There is a breaking point for all of us and once this breaking point is reached, convulsions of the birth of a new society may lead to convulsions of death or some other terrible consequence. It is one thing for Russia to lose its empire, it is another thing for the Russian federation, itself, to begin to disintegrate into pieces. Mind you, this is the real problem that we are dealing with today.

These so-called autonomous provinces and regions -- which include only 15% of the Russian population but comprise 40% of the Russian territory -- they are not necessarily like other republics on the periphery. They are situated in a way that would split Russia apart. The bottom line is that if these autonomous areas really go their own way and the process of disintegration reaches its logical conclusion -- the disintegration of the Russian federation -- it will not end with those areas which are today considered autonomous. You would get a Siberian republic, the Cossacks would organize and demand an autonomous republic as well. There are already signs of these things happening.

Some people would say, so what. Why should we deeply regret, in the name of some artificial stability, a disintegration of this vicious power which for so many centuries was a menace to its neighbors? It is a legitimate question, a sentimental question I would have to say, but from the strategic and economic standpoint, a legitimate one. I have a simple answer.

I have a simple answer because as Prof. Pipes observed, it was in 1917 and before that, during the Time of Troubles in the 17th century -- as the process of disintegration of the state reached its logical conclusion, institutions collapsed -- the very fabric of society was shattered, people lost their self identity. At a certain point people, nations, begin to organize themselves again. In each of these cases, the civil war in 1920 did not start with the Bolshevik take over, it started with the disintegration of society; then during the Time of Troubles, which also started with a collapse of authority, with different Russian regions at each other's throats. Where did it all end? Pushed into the very corner, Russian nationalism reemerged again with great conviction. Just when everyone was saying these people were finished, they mobilized themselves and with the power of arms, reunited Russia. With the power of arms, they were capable of going beyond their borders and settling disputes with their neighbors in a vicious, autocratic way.

However, the difference between the current situation and the situation during those tragic times, is that the foreign community is not trying to manipulate Russian events in a major destructive direction. During the Time of Troubles; the Swedes and the Poles, and to some extent the Ottoman Empire, were trying to take advantage of Russian instability and to support warring Russian factions. During the civil war, of course, the German occupation was a very important reason Ukraine and the Baltic Republics were able to split from Russia. In all those cases, foreigners played a destructive role.

This is the first time in Russian history, where the outside world, during their moment of trial, is not trying to take advantage of them. However, you have to appreciate that they are struggling against enormous odds. The empire has disintegrated with a collapse of traditional economic links.

You also have to remember that Russia played a crucial role in destroying the empire. There, Boris Yeltsin probably did much more to destroy the old union than the Ukrainian leader and all the other republican leaders combined. The tragedy is that the Russians have destroyed their own empire of which they have always been a part. Now they are confused, unsettled, asking themselves not only where to go but what they are.

They have also begun some very interesting but misguided reforms. These reforms are misguided not because Gaidar was foolish, not because Yeltsin was insufficiently decisive but because circumstances were enormously difficult. It would have been very nice to synchronize the monopolization, privatization, and liberalization of prices. It would be very nice to say, "No" to the miners and other groups which were demanding enormous payoffs -- which were only contributing to the inflationary spiral. It would be very nice to put the central bank under the control of the government rather than the party. It would be very nice if Boris Yeltsin did not have this divided administration where, in addition to the cabinet, he has the mammoth presidential administration. This administration appoints special representatives to provinces, most of whom are former party secretaries and play a very important role in privatization on a local level. Needless to say, this creates a situation which very often is at odds with the central government in Moscow. It would be very nice if all of this could be done in a different way.

Well, it could not be done in a different way because we know from American experience that the best economic choices are not always sustainable politically. There were only certain things that could realistically be done in the framework of the Russian political process today, and that is the way they are being done. I am encouraged by the fact that Boris Yeltsin undertook a certain correction, that he told Mr. Gaidar and his American friends from Harvard University and elsewhere that Social Darwinism is not the best way to proceed.

I was delighted to hear from Mr. Yeltsin when I saw him in Moscow, that he was not terribly pleased with American advisors to the Russian government conducting press conferences in Moscow denouncing the Russian central bank in voices completely lacking compassion for the suffering of Russian people. For example that they must take more bitter medicine etc., etc. This was not the right way for foreigners to act in Moscow during these troubled times.

I think that Yeltsin now understands that he doesn't have a very good team of people around him. It would be very difficult to get a very good and experienced team of people around him

because of some of the reasons Prof. Pipes has described and partly because, let's face it, in Russia it was a reluctant revolution. A turnover of elites was not a corporate turnover. In many offices you still see people of the same type as those that had ruled Russia before. One reason there is relative stability during this revolution -- that it did not go bloody -- is that one part of communist tradition replaced another part of communist tradition. But we pay for this stability in terms of inconsistencies between many of these reforms. That is where we are today.

I think that it is quite clear that the West will have to be involved. Debating whether we are going to be involved or not, in my view, is an exercise in futility. We are already involved. Everybody in Russia believes we are already involved. The question is, what is the level of assistance, how should it be focused and what should be the political context for it. Let me make these three points very briefly.

First, in my view, Russia in a certain sense is a defeated country. There is a unique desire (in contrast to post-colonial Africa) to get foreign guidance, to invite foreign financial institutions, to invite technical assistance, but there is another side of the story. The country is in enormous pain. There is a xenophobic fright. I was present at a demonstration in Moscow about three weeks ago where people were distributing leaflets complaining about American satanic influence in all of Russia as well as other western intrigues against the former Soviet Union.

One should be careful when providing assistance, not to create a situation where on the one hand, very little is done but on the other hand, it appears that all that is done is to humiliate and punish the Russians. There is a profound difference between the IMF coming with certain criteria and telling them, "Look, this is what our criteria are in evaluating your request" -- that is reasonable and constructive. Compared to, "Do these things that would punish millions of people because we demand you do these things" -- we have to stay away from such provocations as much as possible.

Again, I understand that this is essentially a contradiction in terms. If you give conditions, you are forcing people to do something but there is an invisible border line between being tough and insisting on those things which are required. Otherwise, assistance will not work; being patronizing and crude only creates an impression that you just want to punish the Russian people.

The second point I want to make, and I'm afraid that a number of people will not like it here, is that the problem of assistance to Russia and the rest of the Commonwealth is far too big to be left to economists. It is just like a war which cannot be left to generals. There are profound political sensibilities. That while you need the World Bank, while you need the IMF, while you need western volunteer organizations; you need a much greater degree of coordination on the top political level among the western community of donors, than we see today. You also have to remember that the Russian political culture is a very hierarchical culture. If you want to talk to Yeltsin, and be able to have him do something, you need an individual and I don't want to call him a tsar -- let's call him a Grand Coordinator -- somebody whom Yeltsin will take seriously. Without these things, we don't have the same leverage which the West's assistance (potentially huge assistance) would be entitled.

Finally, as I tried to say, there should be an overall political context. Russia is a country in trouble. Today, its presence in foreign relations is primarily that of relations with its own republics, former parts of the Soviet Union. That foreign relations start at home, inside former Soviet borders, is a new realization to them but this is a fact of life. There was a certain shock in the West when

Boris Yeltsin canceled his meeting with the Japanese foreign minister and did not attend the Middle East peace conference in Moscow. Instead he was in Novo Sibirsk, in southern Russia, to talk with the commanders of the Black Sea fleet. I think that this was not handled in the best way possible by the West, but that should also teach us one lesson. That today, Russian foreign policy priorities are priorities inside the Commonwealth and primarily the Ukraine.

For too many months, the American administration and many others in the West were dealing with the Soviet Union as if it had a chance to exist. This was a great price to pay for trying to support artificial stability where it could not be maintained. Now I am afraid that some people, Henry Kissinger who will speak with you today included, want to go in the opposite direction. They want to suggest that every attempt on the Russian part to tell other republics that you cannot separate through instant, unilateral declarations, that any question about the status of Crimea -- which never belonged to the Ukraine and which was given to the Ukraine by Khrushchev in 1954 to commemorate the 300 year anniversary of Ukraine's voluntary union with Russia -- that any question about any of that, is inherently a sign of Russian neo-imperialism.

When Russians are telling Ukrainians that, "You signed agreements at the end of December 1991 in Minsk, specifically saying the navy and airforce are a part of strategic forces" and the Ukrainian president, Kravchuk says, "No, Ukrainian fleet is our fleet, Crimea is ours, so the Black Sea fleet stationed in the Crimea is ours, and in two weeks they have to pledge allegiance to Ukraine," then when politicians in Moscow go a little bit berserk -- to call all of this, "signs of Russian neo-imperialism," in my view is misconceived. It would put us at odds with Russia and that would only promote dangerous, xenophobic, nationalistic trends and would only undermine the positions of those in the Russian government who we want to support and who represent the best chance for political and economic reform.

**Steve Meyer**  
**Massachusetts Institute of Technology**

Well I think I'm not going to ruin anyone's lunch. We've been studying the Soviet military and the defense industrial establishment at MIT for over a decade, many of my colleagues have been worried that with recent events I'm going to have to find something else to do. I assure them that that's not the case.

What in fact is the single most important message is that, most of what you've been reading in the news, most of what you've heard in the news about the security problems emanating from the post-Soviet states are in fact, not true. The great hoopla about loose Soviet weapons and, perhaps even worse, loose Soviet scientists has been largely made up. And I'm going to go into some detail and describe that to you. Unfortunately due to time constraints, I can't go through everything I would like but I would hope that if you have questions, we can look at some of those later.

I have listed eight areas that I think have either been very prominent in the media -- most of which are in fact not true; and several which I think are very important considerations -- most of which have not appeared in the media.

Let me start out with the ones I'm sure you're familiar with first: loose Soviet nuclear weapons. This has been in the newspapers now for over six months. What's the threat? The threat, depending on who you speak to, is that the Republican governments will seize their nuclear weapons and then become nuclear powers. This is the threat of nuclear proliferation.

There is the threat that terrorists or small groups operating within the post-Soviet states will seize nuclear weapons at military facilities and thus become nuclear-armed terrorists. There is the threat that rogue military units -- hungry, destitute, lacking apartments -- will as a way of gratifying themselves seize nuclear weapons and hold them for thousands of square meters of floor space. Lastly, there is the threat of accidental launch; that people not knowing what they're doing and being very hungry, will accidentally lean on the button and launch nuclear weapons. I have to tell you I make fun of it because it really is quite silly. It's quite uninformed and misses the point on almost every case.

First of all, there are only nuclear weapons remaining in the four big republics: Belarus, Ukraine, Kazakhstan, and Russia. In fact, it has been that way for quite a long time. So if you want to limit the problem at least to the realistic, you would only be talking about those four states. In fact, almost all Soviet nuclear weapons, with the exception of a couple thousand which I admit seems bothersome but represents probably 10% of the arsenal, are in Russia. More importantly, most of those that are outside of Russia today are in the process of being deactivated and decommissioned, if they are not already in Russia.

The problem that is being discussed, this number you've heard: 27,000 nuclear weapons -- if you've been following this carefully during the summer it was 24,000 and by the fall it had risen to 27,000 and last week it was 30,000 -- I expect that the more the Russians disarm, the higher this number will go. It's an amazing example of number manipulation. But let's say that the number of nuclear weapons that exist are in the mid-20,000 range somewhere, most of those are tactical nuclear weapons, almost all of which have now been brought back to Russia and are safely stored. So the only weapons that we're really concerned about are the strategic nuclear forces that are in Belarus,

Kazakhstan and Ukraine. And the fact is that those governments -- Ukraine, Belarus and Kazakhstan -- can do nothing to use those weapons. It is physically impossible for them to do anything.

There is no such thing as a nuclear button, I hope you understand that. Nobody has a nuclear button, not even Yeltsin. What Yeltsin has is a telephone, basically a telephone in a briefcase which I imagine many of you also have. He calls up the military to authorize them to launch but they don't have to listen. Indeed, there is nothing he can do to make anything take off. So in fact the single person who "has the Russian button" doesn't even have a button. Kravchuk and the leaders of Kazakhstan and Belarus cannot do anything other than call Yeltsin up and insist that he not launch nuclear weapons. Because although they now have telephone lines, given the state of telephones in these former Soviet states, it's not clear they could also get through even if they wanted to.

Nuclear launch crews cannot launch Soviet nuclear weapons, nor could they ever. There are technical mechanisms, not just fail-safe devices but things that have to be done operationally to make those weapons work. Things that cannot take place without a whole series of authorizations from higher up the chain of command. I won't go into the details with you now, but I'll be happy to do that if anyone really cares about this stuff.

The bottom line is this: You've got to distinguish between the location of these weapons, some of which are in other republics. Physical custody, which means actually holding and having control over them, versus operational control. It is true the Ukrainian government could seize control -- physical custody -- of the weapons on Ukrainian territory, but they could not use a single one. It would be a very interesting situation and a very touchy situation, but they could not launch them.

The last point you need to know, if you really care about this, is none of those weapons could be targeted on Russia or Ukraine -- they are all aimed at the United States. I don't know if that is a good point or a bad point, but they're not very realistic in terms of inter-republic warfare because they can't work at those small ranges.

I've already mentioned the fact that a rogue military unit could not seize and operate these weapons. They might be able to seize control of a missile silo but it would be like seizing control of a grain silo. There's nothing you can do other than claim possession of it -- I think it's very important to understand that. Lastly, accidental launch. There is simply not a chance of an accidental nuclear launch. These weapons are not sitting there ready to fly out of a hole. Things have to be done. It is more likely that your automobile could start itself and drive out of your driveway, than one of these nuclear weapons accidentally being launched.

What has really happened -- all the turmoil and the technical problems that have taken place in the Soviet military -- actually make it less likely that if given a launch order, any of these things would take off. The actual problem is the inverse. There is really not a potential threat from the strategic nuclear forces either in terms of proliferation among the other three republics or accidental launch. Tactical nuclear weapons, some of which could have been a problem, have in fact been brought back to Russia and are being stockpiled and stored there. In fact there is a much greater danger, and a real danger I'll come to at the end, that a nuclear power plant accident could seriously contaminate not just Russia or Ukraine but vast parts of Europe and Asia as well.

Let me move on to the problem of loose Soviet scientists, which is not an issue of promiscuity, but a problem of Soviet nuclear weapons establishment scientists, out of work, demoralized by their low status, moving to the third world and helping create nuclear weapons programs in Africa and Asia and Latin America. The fact is this threat is a lot of nonsense. First of all, there are not 10,000 Soviet scientists who have this kind of information -- even though that's the number you see in the paper. The number is probably closer to 2,000, and that number is actually irrelevant. First of all, you have to understand a little bit about Russian culture, Ukrainian culture. Unlike Americans, who would move any place on the globe for an increase in salary, Russians have a very strong tie to their region, their area, their country. The notion that a group of well-educated scientists who lived in closed cities for 25 years would also pick up and move to Libya, as an interesting vacation spot and place to work, is totally nonsensical.

In fact when you sit and talk to Soviet scientists who are in this position, they tell you they will never leave. They're not going to move to these other countries. It's an excellent threat to extort money from the west, but they're not going anywhere. Most of them won't even move to Moscow. When you talk to these scientists -- and you can reach them -- this is the answer you get. But there is another aspect here which I think is more important. Even if Russian scientists move to the third world, they wouldn't make a difference in the proliferation for the following reasons.

1. I think that the argument is a slap in the face at third world scientists. In Iraq, Libya, Egypt, all throughout Asia and Latin America, there are first-class scientists, first-class engineers, trained in Europe, trained in the United States, who are as good, if not better, at the engineering and scientific requirements needed to make a small nuclear weapons program. These people are just as talented. There has never been a shortage of talent.
2. You can buy an American, a German, a Belgian who has that information, and they will move to your country for several years. This in fact has been going on for well over two decades. Therefore the value-added of Soviet scientists moving to the third world is in fact quite small. In fact I would say it is zero. Another aspect of that is the kind of knowledge these scientists would bring is not the kind of knowledge third world countries need.

What keeps these countries from building large nuclear weapons programs is that they cannot get access to the industrial machinery and industrial engineering required to build a big program. Soviet scientists would be no help in this regard. Soviet scientists have lived in these closed cities and they only know their own infrastructure. They know nothing about the world market. What the Libyans need is a Belgian engineer who knows how to get components from companies throughout Western Europe and from components producers in Asia to help build up nuclear weapons fabrication facilities. And Russian scientists haven't the foggiest idea how to do that.

Here again the bottom line is, there is really no measurable threat to the pace of proliferation. What's going on today is basically extortion. These people want dollars so that they can stay home in their research institutes and continue to do weapons research.

3. The problem of loose Soviet nuclear weapons components. I think this is a serious issue. Two threats have been discussed here. One, the threat of fissile material, uranium and plutonium, circulating on the international market and the second part is that other sensitive components that go into nuclear weapons. The first one I think is nonsense. You may have

read reports about fissile material being smuggled out of Russia and being caught by Swiss police in the Alps heading to Switzerland. It never happened. It was a false report. What they actually came out with -- I think this is a con game -- are the little radioactive units that fit into smoke detectors. That was what was trying to be sold to this poor guy as being plutonium, which would have been very interesting in detecting cigarette smoke, but would not have exploded.

In fact the transport of uranium and especially plutonium, is extremely dangerous. Further, the protection of that material inside Russia is quite good. Now it may be possible in future years that some low-level, low-grade uranium ore and milled uranium might end up on the international market from the former Soviet states. But that's true now. There is an international trade in that material and indeed, there's nothing illegal about owning it.

The problem I think really lies with sensitive components. Some of the plants that used to produce triggers, detonators and the other mechanical and electro-mechanical elements that go into nuclear weapons that are very difficult to find on the international market, those plants might indeed sell those components. Especially since there is not a good tracking system in place for that kind of material. It is not protected and cataloged the same way as fissile material.

Consequently it might well be that a country like Libya or Iran would end up manufacturing the plutonium they need from indigenous production abilities but what they are missing are these key components to make that into a usable bomb. That is the stuff they might be able to get from some of the post-Soviet states, largely Russia as a matter of fact. Autonomous and cash-hungry component producers of machine systems, especially equipment that is needed to build the equipment that builds a bomb, might in fact add to the proliferation threat. But if you read the newspapers, you know that in the United States, Germany, Belgium and England there are already companies that illegally sell this stuff and we only catch them once in a while. My guess is that if you are a third world proliferant, you would much rather have western equipment where you can get reliable spare parts, than Russian equipment where you don't know if it will work when you get it.

4. Soviet arms sales to the third world. Yes, I think this is a very big threat, not nuclear arms sales but conventional arms sales. Unregulated sales of Soviet weaponry to the third world is likely to increase in the years ahead as the government of Russia, which has 80% of the defense industry, and to a lesser extent Ukraine, realize that conversion is a joke and if these guys want to keep any of these plants working, they're going to have to sell arms on the international market.

That sale is going to create two kinds of problems. First of all, it will exacerbate existing regional arms races and second, it is going to introduce new weapon systems into existing conflicts. For example, the Iranians have been trying to buy a submarine from the Ukrainians who claim that it's their submarine and the Russians are fighting them for it. They are probably fighting over who will get to sell it to the Iranians, but we're talking about the sale of a sub to a country that previously didn't have a submarine. There are also rumors that India is interested in buying one of the Soviet aircraft carriers. This again would change the character of regional arms races.

I think this is quite a serious problem because the defense industries are desperate for money. They are working autonomously -- without regulation, oversight or control. Local governments, city

governments, regional governments are encouraging them to sell arms. Indeed we even hear that some of the state governments -- the Russian government, the Ukraine government -- are now thinking in terms of global arms sales. I would argue that there is probably covert government approval behind these rumors.

So I think that in the end, Russia and Ukraine will first move to try to sell off the surplus arms left over from the former Soviet Union, of which there are tremendous stockpiles. At the same time, the producers who aren't converting, which are 99% of the Soviet defense industry, will try to stay in business by selling those surpluses.

5. Domestic instability in Russia and Ukraine. I think this indeed is a serious problem. It is a serious problem because, as the central governments become incapable of providing any services -- I think we are beginning to see something that Dimitri Simes warned of -- there will be an atomization of the political process. Local governments, former communist party officials, former KGB officials, former industrialists, and even some local military commanders, have been developing what you might call a "gang territory." There is danger here not of a national military coup against the Yeltsin government, but simply parts breaking off and forming their own little regional governments, regional economies, that bend in the colliding, in a sort of warlord-like fashion.

If there is any threat that worries the US government over the long run, it is the potential resurgence of Russian military power. We heard something about that previously from Dick Pipes and Dimitri Simes. This is the threat that essentially a nationalist government, a xenophobic government, chauvinistic Russian government, will take power and attempt to reassert Russia's regional, if not global, role. Cashing in on what's been left in that country from the former Soviet Union. This is the threat of reversibility.

I have to say that on the one hand, politically, I think it's quite possible. The prospects that a democratic, liberal regime will continue to persist in Russia, is one I find hard to imagine. It is quite possible that one could see in the years ahead, a right-wing nationalist regime. Not a military regime, but a nationalist, right-wing regime that has great power goals. At the same time, that's moderated by the fact that defense industries are falling apart left and right. The structure which made it work is just collapsing onto itself. So the longer a regime like the Yeltsin regime, which is distinctly anti-military, stays in power and effectively allows the defense industrial base and the military establishment to decay, the harder it's going to be for a right-wing group to rebuild Russian military power in a short time.

The basic fact is that you can't dismiss the resurgence of Russian military power. But my guess is that it would probably take any new regime a decade to re-establish itself because of all the damage that has already been done. Besides, with all the problems that regime would face, it probably wouldn't last very long.

Let me finish with one last threat: That is the rise of a major military power among the other republics, Ukraine for example. The fact is Russia has most of the defense industrial base. Ukraine really can't build very much on its own. For example even though they're building or they were building, because now they've stopped, aircraft carriers down in Ukraine, thousands and thousands of

the major components for those aircraft carriers come from plants in Russia and if the Russians don't deliver them, the aircraft carriers will never sell.

The Ukrainians can't manufacture any aircraft other than transports on their own. Even those transports get all their major components from plants in Russia. So the truth is that the Ukrainians can go ahead and try to build up their own military, in a conflictual political relation with Russia, but they will then have planes without wings that don't fly, they will have ships that don't sail, they will have tanks that don't do whatever tanks do. They will have rifles. It will not be a very effective army, it will be a Ukrainian army but it won't be going anywhere other than by foot.

In fact there is a feedback loop albeit an interesting feedback loop. It is that Ukrainian-Russian relations, if they are good, would likely lead to a larger arms trade between them in terms of components -- for no other reason than to keep their industries going. But that would probably help their economic development in a bizarre sort of way because as I said, conversion does not exist there. On the other hand if Ukrainian-Russian relations decay drastically, which could create a great impetus for indigenous arms production, only the Russians would be able to fulfill their needs. The Ukrainians could not do the same without vastly converting major economic resources over to weapons production, and it would be nothing like the Russian's capability.

Let me summarize: If you want to talk about threats, the threats are:

1. The diffusion of critical components and machinery for making not only nuclear but also chemical and biological weapons. Not the core components, not the fissile material, not the biological elements, but the equipment needed to push those programs forth.
2. Soviet arms sales to the third world, or post-Soviet arms sales to the third world which depend on Russian and Ukrainian industries.
3. Domestic economic and political stability in Russia and Ukraine which may coincide with the rise of nationalist regimes, which could lead to inter-republic conflict as they assert territorial claims.
4. This last one I would mention to you again. It is the breakdown of nuclear power plants, which I think is probably the most realistic problem we will face because you talk about people who may walk off their jobs and plants that can't run by themselves. This, is a ticking bomb.

**Edward Luttwak**  
**Center for Strategic and International Studies**

As you know, the Russians themselves are people that always want to live in Act Three of a drama, just like the English always want to be in the Second Act of a comedy. So they dramatize everything, and this dramatization has been flowing into our media for several years. For several years we have been hearing about internal matters: that blood will be in the streets next week and more recently, that there have been a variety of different nuclear scares. I'm very glad that Mr. Meyer dampened all that and took a decisively optimistic stance because I basically agree with that whole thrust.

I will make a few reservations before going on to my own problem. Some of these are very narrow and technical. For example in the category of normal strategic weapons, ICBMs, we have the threat of a silo seizure between Moldova and Gagauz, or a conflict between silo ownership between Ukraine and Russia -- neither give you an operational way of beating up the other guy. Nonetheless, in that same category of normal strategic weapons, there are also bombers. The bombers are not range inflexible and they provide other capabilities. This is no more than a technical correction because of course the political chances of conflict are, I think, not great and I agree with that.

On the subject of tactical nuclear weapons, I think Mr. Meyer is right to be optimistic but I do want to make a slight reservation because as he has himself pointed out, the number of tactical weapons is really huge. These weapons were produced at different points in time over the years and for some, their safeties and controls are of varying quality. Some are much more usable than others. Further, they are not all in the territory of the Russian federation nor do the authorities in Moscow control all the territory of the Russian federation. There are many parts and blotches and pieces of the federation that they do not control and in some of them, there are nuclear weapons and some of them that have nuclear weapons in proximity. So, I agree with Steve's overall thrust, as opposed to what the media has been giving us, but there are reservations and enough reservations that if one is slightly pessimistically by nature, one could stay awake at night thinking about it.

I do have another minor reservation: I do not agree that the Russian scientists don't want to leave or to move. A lot of Russians, a lot of people inside the territories of the former Soviet Union, have different assessments. Many are very comfortable with the advice Mr. Aslund is giving to the regime. However there are others who believe that it will take a little more time than Mr. Aslund believes, and a lot of them want to leave. This migration could impact on peoples' programs in various ways. They won't make anyone a strategic nuclear power of the first order overnight but they could make a decisive difference here and there. The part where I strongly disagree is the part about which I was supposed to talk -- the impact of the change on world-wide security, regional arms races, and so on.

Since 1954/5, the Soviet Union was an arms supplier. Sometimes it sold weapons, sometimes it gave weapons, sometimes it sold weapons on credit (which sometimes they went on to collect) and sometimes it was on credit they had no intention or hope of collecting. The fact that the Soviet Union has remained an arms supplier will make an enormous difference to the whole character of international politics -- it is already beginning to make an enormous difference.

This is not immediately obvious because there are people who envision a world in which there are many arms suppliers. There is even talk of a world arms trade. Well, that is true if you want to

kill your neighbor. If you want to kill your neighbor you can always buy a gun. If you want to fight a small war with a very weak power, you can get weapons from the arms trade. But what the Soviet Union was as an arms supplier -- a supplier that leant, that gave as well as sold -- is something irreplaceable. Its departure will reduce not comfort but the whole question of expenditure in the arms trade -- the whole question of expenditure on the arms race in intensity and impact.

Typically, the Soviet Union did not start conflicts, the conflicts were there. When the Soviet Union arrived on the scene -- supplying one side or the other -- it made all the difference in the world. Soviet quantities made the qualitative difference. The quantities were dramatic. If you wanted to buy jet fighters from the British and the French and the Americans, then you were buying them by the dozen.

You bought twelve French fighters, that is going to be a big weight in your budget. If you bought forty Mirage 200s -- and that's a very big deal even for a country like India, let alone smaller, more typically-sized countries. Compare those numbers to those if you were getting fighters from the Soviet Union, then you were getting them by the *hundreds*. If you were getting tanks, you were getting them by the *thousands*. Artillery by the *thousands*. If you were getting ships, you would get big destroyers and you were getting them in quantity. The quantity was absolutely decisive.

All the other suppliers -- and I'm not talking in general terms of the whole period which of course would change -- did not have the complete range. Subsequent suppliers could only produce this or that, little pieces, components, categories, particular weapons. Other suppliers such as China had a broad range but their quality level was decisively inferior to that of the Soviets'. Until the 1980s, Soviet quality was such that you could say that the American was better, the French was better, but the difference was in degree. When it came to tanks, the Western tank was maybe thirty percent better but it cost three hundred percent, *three times*, more than the Soviet counterpart. The jet fighter would be five times more expensive and it would be -- until the 1980s -- marginally better. It is true that in the 1980s the general dysfunctions in the Soviet Union caught up with arms production, reflected itself in the difference in quality, which was very great. Still it made an enormous difference. Where did it make a difference? Well, most visibly in the Middle East where the entrance of the Soviet Union in the Middle East in the 1950s changed the fighting from one that was done with rifles, machine guns, mortars, armored cars, and handfuls of leftover ancient tanks into large-scale stuff. Big wars with lots of equipment -- that made the difference.

It made a difference to the budgets in these countries. The fact that the Soviet Union was in the region as an arms suppliers meant that arms supplies, that defense, was a decisive factor in your budget. Was it only in the Middle East? No. There was of course Viet Nam. There was also an impact on South East Asia, though not so strong and much latter. In Latin America, when the Soviet Union came in as a supplier to Peru, suddenly you had tanks showing up where previously they did not exist and real battleships which until then did not exist that part of the world. Some parts of the world were much more autonomous, but they were very rare. For example in the Korean case, the scale of Soviet supplies was important in the 1950s and 60s but it declined in importance in the 1970s and 80s when there was much more self-sufficiently. Korea really is an exception as it continues to be a security challenge in the modern era. The departure of the Soviet Union as a country that sells large quantities at relatively close to the best quality as well as training and maintenance, and has a commitment to the recipients -- even though the recipients of these Soviet weapons always complained because spare parts were hard to get -- the fact was that they were getting them.

When you buy your fighter from Dassault for example, you have to take a big chunk of your GNP and they send you twelve beautiful aircraft. And then you want to start upgrading them, and they say, "*Oh, we didn't know you wanted to fly them. You want to fly them? Here is the maintenance contract*" -- which then takes the other half of your GNP. We can therefore see that in straight economic terms, the GNP fraction that goes to defense, is in a major way affected over time by the departure of this unique supplier; unique in scale.

Another impact on the West: President Bush plans to reduce defense spending by 20 or 25% over the next five years. There is absolutely no chance at all of this actually being the case. Unless there is another change in world affairs of the kind that one cannot anticipate, the cut will be more like 50% and this will be -- generally speaking -- true of the other areas that were not supplied by a strategic relationship with the Soviet Union including NATO, Europe, the United States, and East Asia to some degree. Defense budgets everywhere are going to precipitously decline because even the most fertile minds find it very hard to invent threats.

We are now at the stage of institutional stickiness where institutions don't want to accept these changes. They are fighting and resisting them. Inertia and employment are defense industry issues, but you can't sustain this for very long. The truth is that the whole character of world politics was "ripe to transition into a geo-economic era" -- an era where the logical conflict between nations may persist but the method of conflict becomes economic. An era where capital availability displaces firepower, where the ability to produce products for the market displaces military R & D, where market penetration displaces garrisons and bases. The world was ready for it. It was only the peculiarity of the Soviet Union, attempting after the collapse of its ideological hopes, to maintain itself through military means.

The fact that the Soviet Union is gone will have an impact on national budgets, with some modifications and exceptions. There will be some Chinese and Korean weapons, and sales from the inventory of the Soviet Union. But getting [buying] a shipment of tanks from the Soviet Union today is completely different than in the past. You will not get thousands nor are you going to get them maintained. If you have a problem operating them, the Soviet Union will not send hundreds of thousands of technicians to do it. In the past you may have complained about the spare parts but now you can just forget about any spare parts. You buy a shipment and you have to maintain it by cannibalization.

The only other thing I want to say is that we are not entering universal peace. The exceptions may not be important if one has a global perspective but for individual countries, exceptions are going to be important. There are countries in the world which are involved in conflicts whose levels of intensity are quite low and where even a country like Brazil can be a sufficient supplier. After all, there are parts in the world where tanks can't function. In sub-Saharan Africa, with the exception of a few in Nigeria, there are no battle tanks. That is again, until you get to South Africa. There are parts of the world where the Chinese are enough, Korea is enough, so there are these reservations. There are exceptions in Europe itself. For example, a country like Italy was coasting -- in national security terms -- for forty years because it was the flank of NATO so that the war was going to be won or lost in Germany, and the winner would keep it. The Italians didn't have to do anything, so they just did a pro forma two percent for defense. Now they no longer find themselves in the flanks but rather, right there in the front lines, an outpost next to the Baltics. For the first time they have to take defense seriously. Albeit to the European context, albeit to the collective context. For the first

time defense will be real for them instead of being pro forma. Instead of being a branch of the opera, defense has now become something you really have to do seriously. In reality, politically, if a Libyan warhead falls and kills a dog in Sicily, this will be a real threat, a tiny threat but a real threat. The exception may not be important in the global perspective but they can be very important for individual countries.

As to the question about the resurgence of some power entity within the territories of the former USSR, I completely agree with the general tone and character of what was said earlier but I would like to make a slight modification. First of all, it is very dangerous to use the term xenophobic because what is xenophobic in one culture is quite normal in another. The level of suspicion of the external, of outsiders, that historically has been present in Russia has been much higher than that in certain other cultures. What is xenophobic in Japan or in Korea is not what is xenophobic here. A xenophobic American approaches the norm in some other cultures.

What security concerns do we have in terms of world-wide impacts? I think the boundary limits are between a liberal democratic regime -- a regime that is structured democratically but may be a little less liberal -- and a regime that is authoritarian in a manner as we actually have forgotten but whose meaning in the classic manner is to think of how sellers are in Portugal, France and Spain -- a regime that cannot conduct external relationships very successfully, so that it is somewhat isolationist but not isolated or cut off; one which is not democratic but is not totalitarian. All of these configurations strike me as not the kind that would bring about a Russian or Moscow-based power that wants to go doing things on a world-wide scale once again. These are all configurations, some are pleasant, some are less pleasant; they are not configurations to bring back a globally active Russian power. In that regard we would simply say that with the passage of ideology, the Russian people have reverted to their normal modus operandi. Namely: always a great people, with a big heart, with great talents, with great capacities. Not an internationally active people but a globally active people, other than strictly territorially.

How did they get to be so huge? By territorial addition. Why did they do it? Because of the ideological phenomenon which has passed. Hence this adds to my perspective that we have entered into a period which the transition from the outdated projection of aristocratic desires and ambition, which we call geo-politics -- doing things through war and diplomacy -- was artificially prolonged by the phenomenon of the Soviet Union. We instead went into the transition of geo-economics, which unfortunately is not the same as economics. We can see this from the phenomenon of Airbus. Just as in the past when nations were able to take their young men, put them in uniform and march them to the railway station and send them somewhere to conquer a foreign province, today they take their taxpayers and make them provide the resources to conquer a province called passenger jets. The geo-economic world is not a world of universal harmony and peace but it is one in which there are economic modalities and interactions.

**Henry Kissinger**  
**Kissinger Associates, Inc.**

I speak with some trepidation before this group. For I remember the time when your President was Chairman of the Morgan Bank -- he would get me in every once and a while and, in his extraordinarily gentlemanly way, tell me I had not a clue as to what I was talking about when I discussed Latin American debt. When I was in government, Bill Simon once said that my knowledge of economics was the best argument against universal suffrage. Then again Bill Simon proved his political acumen when, at the height of the oil crisis, he called the Shah of Iran a nut in public. So I called him up and said *you can't do that*. He said, *Oh, you political types always get too excited*. He said, *I'll get it fixed by this evening*. By evening, he had put out a statement that he had been quoted out of context. The poor Shah went to his grave trying to figure out in exactly what context he could be called a nut. So, I hope you will bear with me.

I must say Mr. Aganbegyan shook me up a few years ago when I visited the Soviet Union and Gromyko was President. I visited Gromyko, who seemed to have plenty of time. I asked him *What does the President of the Soviet Union do?* And he said, *he settles disputes among the republics*. Just to show you how things have changed, I said *Give me an example of a dispute among the republics*. He couldn't give me a single example of a dispute among the republics. So I told this to our friend (this was still in the days when one thought of the Soviet Union as a monolithic state), and he said *Gromyko is a liar*. Then I knew things had already changed somewhat in that period.

Now I know you have had a number of talks on economics, and a number of talks on the military situation. Nor am I an expert on the Soviet Union. I look at it as a political and strategic issue, therefore I may be wrong on particular economic judgements. I used to read Mr. Aslund's papers over the years, and I must say he was obviously right. So I am heavily influenced by what he is saying now and I do not challenge his propositions, though I would not confirm them either. That reminds me -- and then I'll really get to the subject -- of something during the Vietnam War: We wanted to find out what was going on in Cambodia, so we sent in there a distinguished foreign service officer who wrote the following report:

*Before I went to Cambodia, he said, I thought the chances of its survival were fifty-fifty. I have seen nothing there to question that judgement, and nothing to confirm it either.*

At this point, he was fifty-fifty about a fifty-fifty proposition. We certainly had a masterful insight into what to do.

Let me talk now about the foreign policy problem facing the United States as I see it emerging out of the current situation, and the foreign policy conclusions I would draw -- into which I will try to fit a few economic observations.

What we are witnessing are two huge revolutions: (i) the revolution against communist central planning, which has unraveled seventy years of communist history, and (ii) the revolution against Russian imperialism, which unravels three hundred years of Russian imperial history. They are not the same phenomenon; you can be on one side of one of these revolutions and on the other of the other, and neither of them would necessarily make you a democrat. When I read statements by American leaders saying *This is now a democratic experiment, and we have a commitment to democracy*, I must admit I have very great doubts that is really what is going on in the Soviet Union.

A few weeks ago, I was at the World Economic Forum in Davos, with eight of the eleven non-Russian presidents of the republics present. Since I had to introduce them, I got their curriculum vitae and, except for the Armenian, every last one of them was not only a communist, but had never had any other job except as a communist cadre, which made it rather difficult to introduce them as great beacons of democratic thought. I certainly believe they are now probably all anti the previous system, for they have understood that, to survive, they have to be nationalists. That I do not question for a minute. But we should not delude ourselves that a huge democracy is emerging there yet. Secondly even such democratic aspects as there are seem to me to be of the plebescitarian-democracy kind out of which dictatorships very often emerge.

Now I have high regard for Yeltsin. I urged that he should be treated with much more respect than it was fashionable to at one time. But, still, he is a phenomenon of the referendum-type of democracy. It may be the only type that is now possible. Certainly I would prefer democracy in the Soviet Union, but I can also imagine other outcomes, and it is the duty of American foreign policy to work for peace and to produce the best outcomes, even if our preferred solutions do not emerge in every way.

I consider it quite possible that there may be interim arrangements in the former Soviet Union that are not strictly parliamentary. What I do believe to be clearly happening is the breakup of the old imperial system. Chaotic conditions always prevail when central planning disintegrates, chaotic not only because the old system is disintegrating but because nobody yet understands the new system, and even managers of the so-called privatized industries are really just the old monopolists who have not learned yet how to operate free markets. I talked to Mayor Popov of Moscow, who I am sure some of you know, and he told me that at least during this winter he could not go over to the money economy, but had to function by the old barter system dealing with regional groupings. But you will all be able to judge that better than I. Let me talk about what I take to be the foreign policy problem. In my contacts with leading personalities in the former Soviet Union, I would make the following statement: I have yet to meet a leader of the Russian republic or a potential leader of the Russian republic who accepts the breakup of the Russian empire. I have yet to meet a leader of any republic who accepts the continuation of the Russian empire. That is a fundamental fact.

You meet many people in Moscow who register the proposition that the Baltics--for all practical purposes--are independent, that the Ukraine declares itself independent, and that all kinds of other outfits declare themselves independent. I think if you gave them a truth serum, they would say *we've gone through all of this before. We had the same thing in 1917, and by 1922 we had them all together again.* I would go so far as to say that a substantial proportion of leading Russians would apply that even to the Baltics. But in the Baltics I think they can maybe swallow it.

With respect to Ukraine, Kazakhstan, Belarus, and other republics, I would really say, they do not in their hearts accept this, at least not the ones I met. I had dinner with ten yuppies which the embassy produced for me, so I assume they were not looking for the most anti-American group they could find. I held a briefing with them -- some television commentators, some doctors, some lawyers, all moderately to very successful. I was astonished by their extreme nationalism. They were not wildly enthusiastic about the United States. Much of what we do they consider arrogant, which is hardly what we intend. Yet, who are we to keep lecturing them about a new world order? Who are we to think that a McDonald's in Red Square is going to change a people with a long history? All of this is, incidentally, very understandable and doesn't offend me, but we cannot ignore

the impact of this ongoing foreign policy problem of the United States which seems to me to go back to Wilson. Most other nations, rightly or wrongly, have thought of foreign policy as addressing the problem of some kind of equilibrium; and of the penalties and rewards of foreign policy as producing some desired course of action.

America has always been unique among the nations of the world in thinking of the issue as one of conversion -- that if you can "convert" the adversary to our American values, you solve not only the problems of economy but also the problems of war and peace. So, when we went into World War I, President Wilson did not say, *there is a danger to the peace of the world and to the balance of power if the Germans win the war*. What he said was, *we are not fighting for the balance of power, we have got nothing to do with balance of power. There is this evil character, the German Kaiser, and we've got to get rid of him. He has deceived the German people*. Now the Kaiser had been around for twenty-nine years, during which it never occurred to anyone that he personally posed a threat to peace. One of our American problems is that we have now talked ourselves into the frame of mind that we've got to get democracy and market economics into Russia and that it can all be done in a measurable period of time; that after that, there will be no more problem of peace, all our international problems being the result of Russia's internal structure. I do not believe it is possible to get market economics in Russia in a measurable period of time, though I am all in favor of the program Mr. Aslund recommends. I would now simply put to you the issue as follows: When a nation has acted in a certain way for four hundred years, I deduce from that--perhaps from a limited perspective--a certain proclivity. It cannot be an accident that a nation has never had legitimate successions or that of the Czars between Peter the Great and Nicholas the Second, only three died in bed, though one of those deaths is still in dispute. What all of that indicates is a certain difficulty with the constitutional system.

Now, let me talk about the foreign policy problem. What exactly has been the foreign policy problem of Russia? It started its expansion from the area around Moscow out in all directions. The colonies of the European nations were distant from their mother-countries, but Russia's conquests were contiguous territories. Russia always had to have a larger army than any other comparable country, because it kept inventing the existence of ongoing outside dangers greater than the internal rivalries among its own various nationalities. The more it expanded, the worse the feeling of threat became, setting up a vicious cycle in which the more people it frightened by its behavior, the more hostile they became toward it and the greater the need to increase security. Therefore, I belong to the tiny minority that believes that the foreign policy problem of the United States today is to discourage recentralization of the Russian empire, and to educate the Russian leadership to the implications of this proposition. For they are governing a territory that extends from St. Petersburg to Vladivostok and encompasses eleven time zones and a hundred-eighty million people. They have twenty-thousand-plus nuclear weapons. They are not under any threat from the surrounding world. The only threat from the surrounding world that they could suffer is the one they create themselves by going back to the patterns of their history. I think that a Russia that stays substantially within its own borders (and, of course, becomes a significant power irradiating all the others), on the same basis as the cooperative European nations, would solve many of the security problems of Europe, as well as most of the security problems of historic Russia. I do not think that is being done right now, yet it is a context through which the economic recovery of Russia would benefit everybody and which I would enthusiastically support.

I get very nervous when I hear all these reformists, the assistant professors running loose proposing all sorts of practical schemes of reform that assume a strong Russia is inevitably in our interests. It is inevitably in our interests only if it keeps within the bounds I have described, which would also be within its own best interest. And this would represent a change in their thinking. The leading Russians I talked to are all smart enough to know they can't do very much right now. But they are also too nationalistic to accept that all this is anything but temporary, and that is going to produce a colossal mess. I saw their defense ministry, which is by far the most efficient ministry in the former Soviet Union; very well run, by able people, all seemingly in possession of their own generators so the light bulbs burn a little more brightly there than they do elsewhere. And they are smart enough to know that they are in no position to do anything militarily right now. Nor are they under any political control at the moment. They consider themselves to be the defense ministry of the commonwealth and they think it is their duty to protect the external borders of...of what? I think if you gave them all a truth serum they would even include the Baltics, but certainly everything except perhaps the Baltics. So here you have a huge defense establishment that is under no political control: the KGB is gone, the Politburo is gone; Yeltsin is there whom they support more or less, but they certainly don't have to as there is no constitutional obligation for them to do so.

So I would define the American foreign policy problem as being able to come up with some vision of what we want to emerge over there. And that requires really serious dialogue, not this business of pretending that if they can only raise their standard of living, everything is going to automatically solve itself. Within that context I repeat I am strongly in favor of helping the Russian state. I am also in favor, however, of helping the republics, and I think it is very dangerous to treat the Russian republic as the successor state of the Soviet Union, above all, dangerous for them; or to create the image in America that Yeltsin is the successor of Gorbachev. Yeltsin is the successor of nobody. It is a new state, and he ought to be treated in his own right. By treating him as the successor of Gorbachev, therefore of Stalin and of the Czars, we create the image that he is in a special position along with the Russian republic, so it can speak for all the others.

I think it is important for us to have stabilization programs and envisage them as including as many of the other republics as is possible. I would also call special attention to Central Asia. I met the President of Azerbaijan a few weeks ago. He had a superb interpreter with him. I complimented him on his interpreter, and he said, *He's not my interpreter, he's my advisor. Moreover, if you want to get in touch with me, get in touch with my advisor.* I asked where to do that, and he said *in Ankara. He is on the staff of President Ozal, and he spends two weeks a month in Baku, and two weeks a month in Ankara.*

Yesterday I met with a leading Pakistani who told me of some arrangement that exists between Pakistan, Iran and some of the Central Asian republics. What we are going to be seeing there is a real impact on history by Iran, Turkey, Pakistan, and maybe the Chinese through Kazakhstan. And where are we? What is the United States' interest in this? How do we vindicate it? How do we make our presence felt? Incidentally, I think that in relation to Central Asia, we do have a common interest with the Russian republic to discourage the spread of fundamentalism, therefore in certain economic programs in those areas, as well as such republics as are small enough, so that even smaller sums make a big difference. I look at this from a foreign policy, geopolitical point of view, which may seem antithetical to you, but I did just want to sketch my own approach and why I am somewhat worried. If you look at the history of America's approach to foreign policy, we simply do not think in structural terms but rather, always, in personal terms. Do we support

Gorbachev? Do we support Yeltsin? Are they becoming democratic (and then all the problems will disappear)? I recently read some discussions relating to the ratification of NATO in 1948. We spent days on testimony proving that it was not an alliance, with the State Department presenting a historical document--or an allegedly historical document--that showed the difference between NATO and all the alliances that had ever existed, the reason being that Americans wanted to make sure they were operating in a universal system of collective security, not in a traditional system of alliances that would consign us to having "interests."

We must above all understand what it is we want in the former Soviet Union. What we want, in my view, is compatible with and necessitates the progress of that area. Having come upon an adequate political framework, we cannot just say, *Let it all happen*, because if we let it just happen and it fails, there will be chaos. We all know that. If it succeeds, it could lead to recentralization and a resurgence of imperialism, and we cannot want that either, because then the whole outside world will again feel threatened and begin to mobilize, and remilitarization will follow.

Though I have put it in rather excessively brief terms, these then are my very general observations.



# COLLOQUIUM ON THE FORMER SOVIET UNION FOR THE EXECUTIVE DIRECTORS OF THE WORLD BANK

SOCIALIST ECONOMIES REFORM UNIT  
COUNTRY ECONOMICS DEPARTMENT  
FEBRUARY 27-28, 1992

## PARTICIPANTS

Mr. Ibrahim A. Al-Assaf  
Executive Director

Mr. Fawzi H. Al-Sultan  
Executive Director

Mr. Aris Othman  
Executive Director

Mr. J. S. Baijal  
Executive Director

Mr. Mohamed Benhocine  
Executive Director

Mr. Rosario Bonavoglia  
Executive Director

Mr. Felix A. Camarasa  
Executive Director

Mr. E. Patrick Coady  
Executive Director

Mr. John H. Cosgrove  
Executive Director

Mr. Harald Rehm  
Alternate to Mr. Fischer

Ms. Eveline Herfkens  
Executive Director

Mr. Jean-Pierre Landau  
Executive Director

Mr. Philippe de Fontaine Vive  
Alternate to Mr. Landau

Mr. Leonard Mseka  
Advisor to Mr. Langley

Mr. Ali Bourhane  
Alternate to Mr. Le Boudier

Mr. Ernest Leung  
Executive Director

Mr. Einar Magnussen  
Executive Director

Mr. Moises Naim  
Executive Director

Mr. David Peretz  
Executive Director

Mr. Frank Potter  
Executive Director

Mr. Kiyoshi Kodera  
Alternate to Mr. Shiratori

Mr. Bernard Snoy  
Executive Director

Mr. Wang Liansheng  
Executive Director

Mr. Lewis T. Preston  
President  
World Bank

## Presenters

Dr. Abel G. Aganbegyan  
Academy of National Economy  
Moscow

Professor Anders Aslund  
Stockholm School of Economics

Dr. Henry A. Kissinger  
Kissinger Associates, Inc.

Dr. Edward Luttwak  
Center for Strategic and  
International Studies

Professor Steve Meyer  
Massachusetts Institute of Technology

Professor Richard Pipes  
Harvard University

Professor Jeffrey Sachs  
Harvard University

Dr. Dimitri Simes  
Carnegie Endowment for International Peace

Dr. George Soros  
Soros Fund Management

Mr. Lawrence H. Summers  
Vice President Development Economics and  
Chief Economist

Mr. Strobe Talbott  
Time Magazine

Dr. Norbert Walter  
Deutsche Bank

## Observers

Mr. Wilfried Thalwitz  
Vice President, Europe & Central Asia  
Regional Office

Mr. Timothy T. Thahane  
Vice President & Secretary

Mr. Arnold T. Clift  
Deputy Secretary

Ms. Nancy Birdsall  
Director  
Country Economics Department

Mr. Russell J. Cheetham  
Director, Country Department III

Mr. D. C. Rao  
Director  
International Economics

Mr. Parvez Hasan  
Chief Economist, Europe & Central  
Asia Regional Office (ECA)

Ms. Gisu Mohadjer  
Assistant to the President

Mr. Alan Gelb  
Division Chief  
Socialist Economies Reform Unit

Mrs. Cheryl Gray  
Senior Economist  
Socialist Economies Reform Unit

Mr. Richard Hirschler  
Editor *Transition*  
Socialist Economies Reform Unit

Ms. Vesna Petrovic  
Research Assistant  
Socialist Economies Reform Unit

Ms. Cecilia Guido-Spano A.  
Administrative Secretary  
Socialist Economies Reform Unit

**Annex 1**

**Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economies Reform Unit, Country Economics Department**

## **Seminar on the Soviet Union**

**Room F-1244  
Wednesday, 30 October 1991**

**World Bank  
Washington, DC**



# Seminar on the Soviet Union

Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economics Reform Unit, Country Economics Department  
Wednesday, October 30, 1991

## Room F-1244

8:30 – 9:00 am

*Breakfast*

9:00 – 10:15 am

### **The Current Economic and Political Situation**

*Chairperson:* Lawrence Summers, DECVP

*Speakers:* Anders Aslund, Stockholm School of Economics

Peter Reddaway, George Washington University

10:15 – 10:30 am

*Break*

10:30 – 12:00 pm

### **The Economic Strategy**

*Chairperson:* Lars Jeurling, EM5TC

*Speakers:* John Williamson, Institute of International Economics

Mario Nuti, European Community

Martin Weitzman, Harvard University

12:00 – 1:30 pm

*Lunch*

*Executive Dining Room D – Room A*

1:30 – 3:00 pm

### **Inter-Republic Relations and Trade**

*Chairperson:* Alan Gelb, CECSE

*Speakers:* Paul Goble, U.S. Department of State

Stewart Brown, Georgetown University

3:00 – 4:00 pm

### **Military Conversion**

*Chairperson:* Jonathan Brown, EM5IV

*Speakers:* Dean LeBaron, Batterymarch

Steve Meyer, Massachusetts Institute of Technology

4:00 – 4:30 pm

*Break*

4:30 – 5:30 pm

### **The Role of the West**

*Chairperson:* W. A. Wapenhans, EMNVP

*Speakers:* Jeffrey Sachs, Harvard University

John Hardt, Congressional Research Service



# SEMINAR ON THE SOVIET UNION

Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economies Reform Unit, Country Economics Department  
Wednesday, 30 October 1991

## Summary of Main Points

*Cheryl Gray*

*Socialist Economies Reform Unit*

1. **The Soviet Union is on the verge of anarchy.** "No one is in charge." *The Center is irrelevant and the current Union Treaty "impossible"*. Even within the Russian Republic there is extensive bickering. Current Union leaders, and even leaders of the Russian Republic, could be out of power within 6 months.
2. **The economy is collapsing.** Tax collections have fallen precipitously. This year's total budget deficit is estimated at 25-30 percent of GDP. Recorded inflation is now running at 200-300 percent, but actual inflation is much higher. GDP will probably decline this year by 20 percent. The system is in crisis and has lost all legitimacy; there are no incentives, and people are going to work out of sheer inertia.
3. **Thorough reforms are needed,** beginning with macroeconomic stabilization, price liberalization, and a rapidly-improvised social safety net. Although debt relief is not called for, debt rescheduling is needed immediately in order to ameliorate the short-run liquidity crisis. Privatization could begin immediately (concurrently with the stabilization) with the giving away of 20-30 percent of shares in enterprises to their employees; this would give workers and managers an incentive to think long-term rather than immediately decapitalize their firms. Given the low technology and highly specialized nature of much military industry in the Soviet Union, military conversion will not and cannot be an engine for economic change; at best it will be a byproduct of economic change in the few cases where world-class potential exists.
4. **The plan put forward by Yeltsin on October 28th is the only glimmer of hope in the current situation.** The plan, formulated by the State Council under Igor Gaidar, calls for a "big bang" price liberalization in just two months time. The plan is likely to be implemented, because there is no other choice. Yet the plan is fraught with risks, particularly because the public is completely unprepared for the pain that will result. The situation is "tragic" in a classical sense: the outcome is likely to be horrible (far worse even than in Eastern Europe), but there is no alternative.
5. **The breakup of the Soviet Union can be a good thing both politically and economically, as long as inter-Republican trade can be maintained.** Politically, smaller units have a greater chance of creating some political legitimacy that makes reforms possible. Economically, smaller units can implement reforms more easily, and competition among Republics is likely to accelerate the reform process in each. (For example, as some Republics liberalize prices, pressures will build for others to do the same.) A single currency and monetary and fiscal system is not necessary for economic interaction; open trade (facilitated by a central payments clearance mechanism, whether or not supplemented by the credit facilities of a payments union) is the main requirement. Movement away from a single currency (i.e. currency reform) should ideally be done in a coordinated fashion. There are precedents for this, and Western technical assistance can help.
6. **The West should be moving forcefully to make contacts with Republican governments and, in particular, to support Yeltsin's plan.** The West should be responding with strong promises of aid, conditional on reforms being implemented. The situation is not unique; there are in fact many precedents for how to support a stabilization program. The IMF could take the lead with a "shadow standby", following closely with a "shadow SAL" from the Bank. Time is of the essence given Russia's impending reforms; ideally a program of support should be in place by January 1, 1992.



## SEMINAR ON THE SOVIET UNION

Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economies Reform Unit, Country Economics Department  
Wednesday, 30 October 1991

### PRESENTATIONS

#### SESSION ONE: THE CURRENT POLITICAL AND ECONOMIC SITUATION

*Larry Summers*

... in the interest of time I'll dispense with the usual pleasantries about how we're all happy to be here with each other. I think the issues here are large enough that we should spend as much time on them and as little time on the formalities as possible. Let me just suggest two things that may make our interaction smoother. One is the uncertainties here are so great the discussion is likely to be much more productive than speeches. So let me implore the initial speakers to keep to their time limits and implore the chairmen to be rigid about achieving that objective, and I will try to set a good example with respect to this session. Let me also suggest that when we have general discussion people try to keep their comments brief and if people could identify themselves before they speak that would be helpful as well.

On this first panel to overview the broad contours of the current situation we are pleased to have Peter Reddaway and Anders Aslund. In keeping with my principle of trying to move things along I will not give them the flowery introductions they deserve but instead rely on you to know of their distinguished reputations. Peter.

*Peter Reddaway*

Thank you very much. I think at this juncture vis a vis the former Soviet Union we are all tempted to give in to the very understandable human failing of not wanting to believe unpleasant things and preferring to believe the most optimistic possible interpretation. I think that is a very serious failing at the moment, and I hope that my remarks will do something to counteract it.

As those of you who have had a chance to read my article in the current issue of the *New York Review of Books* will know, my own opinion is that, over the last two to three years, you have had two parallel revolutions going on in the Soviet Union, one the anti-imperial revolution and the second an anti-Communist revolution, overlapping with the first of course extensively, and both those processes have accelerated each other, and in turn both of them have been greatly accelerated by the economic decline, which has become a crisis.

What happened with the coup attempt in August of this year is that I think it provided the final catalyst, if you like, precipitating the definitive success of the anti-imperial revolution. The Soviet empire simply broke apart finally, at that time having been in a state of advanced decay for quite a number of

## 2 Seminar on the Soviet Union

months and even a year or two. The biggest tragedy of this breakup of empire, the ramifications of which are enormous, is that there were no significant arrangements made in advance of the breakup of the empire for the post-imperial political or economic structures. Most of the more impressive empires have managed to provide something for post-imperial structures prior to their demise: the British or French empires. You get the British Commonwealth with various economic and political arrangements, the French Community, and one or two others.

The center in the Soviet Union, the central government, federal government, had lost authority over the years '88, '89, '90, '91. Thus when the coup collapsed, the empire collapsed, there were no provisions for post-imperial structures and as a result in my opinion the extraordinary confusion and bickering and quarreling that is now going on does not have within it the seeds for any sort of political union to emerge out of this collapse. Any economic union that may emerge will be extremely fragile, unstable and probably not signed on to by very many republics, and the prospect for a general decline into increasing anarchy is rather impressive, the prospect there is rather daunting.

The republican leaders are all now concerned to try to establish or shore up some sort of legitimacy in their own republics. This is an extremely hard task for most of them. Many of them have not had popular mandates up to now, they've not been elected. Some who have, like Boris Yeltsin, are desperately been trying to hang on to their mandates and shore them up. Essentially the Soviet Union, the former Soviet Union, is now fifteen different countries. Three of them are acknowledged now as independent countries—the Baltics. But the other twelve are also essentially independent countries, trying in a very ill-coordinated way to work out some sort of arrangements among themselves but with the centrifugal forces in my opinion considerably stronger than the centripetal ones.

A few remarks about the collapse of the center, to make it a little more explicit. Gorbachev's authority has simply vanished. He has no authority. Mr. Yakovlev, one of his closest associates and allies, said a few, a couple of weeks ago, "I am tempted to tell you the truth. No one is in charge." That's, I'm afraid, the truth.

To take some particular institutions, the military one would have thought would be the central part of whatever union might possibly be preserved. But the military, even that, is falling apart. The Ukrainian government has declared that it in effect owns all the Soviet military equipment and facilities on the territory of the Ukraine. It henceforth will run the Black Sea fleet, for example. Azerbaijan, another republic, has nationalized all the military facilities and equipment on its territory, and it is making its own army and military out of those components, and the general trend in other parts of the country is similar, although by no means uniform.

Another institution that one would have thought would have to be preserved in some way if you were going to have any sort of union emerging, the KGB, the committee of the state security, has been divided up, bits are being hived off from it. Mr. Yeltsin passed a decree, a couple of weeks ago, saying that Russia's KGB is the legal successor to the all-union one, and in general it has been dismembered and has lost all authority.

The whole question of Russia becoming the legal successor to the union is one which Mr. Yeltsin's closest lieutenant, Mr. Burbulis, clearly seems to favor, and he went to visit Mr. Yeltsin when he was on holiday recently, came back and said Mr. Yeltsin reacted normally to the notion that Russia should become the successor, the legal successor, to the union. In another words, the union would simply cease, totally cease to exist in any way at all and Russia would take over its functions, and whatever crumbs it might decide to give out to other republics would be up to Russia to decide.

The center is supposedly due to have some elections in the new year for the union presidency and for a new union legislature. I think it's most unlikely that any such elections will take place, and Mr. Gorbachev will therefore very soon be out of a job and there will be no union legislature.

The temporary, interim legislature, the Supreme Soviet, met for the first time on October 21. It was meant to meet on October 8. It was clear that very few people would turn up. It did meet on the 21st. There were precisely half of the number of delegates that actually appeared. Some republics didn't form delegations at all and were not represented even by anybody.

As regards the economy, I think the analysis of Mr. Yeltsin's chief economic adviser at the moment, Mr. Gaidar, is essentially accurate, and I'd like to quote it. It's actually from today's *Washington Post*. He says the central government no longer has any power to steer the economy. "In a recent interview he said that Western financial institutions would have to abandon attempts to deal with a single central government. 'There are now many centers of political power. I agree this is inconvenient. It is economically destructive. But it is political reality, and it must be taken into account.'"

I think that's an accurate analysis. I won't go into the details of the attempts to form a new economic union treaty. I expect Professor Aslund will do more on that score. Suffice it just to repeat, I think the chances of any effective or viable economic union emerging are extremely remote. The credit rating, to take another item from today or yesterday's paper, of the Soviet Union has now slipped to 111th (one hundred eleventh) around the world, and that seems to me as a political scientist to be about right. (Laughter.) And that's on the same level as Chad, incidentally, in Africa.

To focus a few remarks on the Russian Federation, and this of course is by far the largest component—about half of the population of the former Soviet Union, almost 150 million people. It's clearly the key. Don't think that there's going to be any political stability in the Russian Republic. The Russian Republic is going to be as battered by political and economic turmoil as just about all the other parts. Three of the republics that have become independent, the Baltics, they are the ones that perhaps have the greatest chance for some sort of political and economic stability in the future. Russia certainly does not, despite the fact that Mr. Yeltsin was popularly elected by a fairly strong vote and despite his heroic resistance to the coup in August. His closest associate, Mr. Burbulis, whom I referred to earlier, said recently that the Russian government is only about 70 percent in control of Russia and "with every day" it is losing more and more control.

The draft constitution of the Russian Republic is being blocked by various groups within the parliament, and the chances of a quick adoption of a constitution seem to me to be poor. Throughout the regions of the Russian Republic, the conservative forces are still very strong in many places, and as a result Mr. Yeltsin was obliged to go back on one of his promises to hold elections for local heads of administration. He was afraid that conservatives would be elected to leadership of local administrations—in other words, people in tune with the old, central ways of doing things, and of course with the Communist party. One of the biggest sources of instability in the Russian Republic, as elsewhere, is various ethnic minorities, which have their own administrative units. In the case of Russia the most important ones are called autonomous republics. Yeltsin and his administration, including Khasbulatov — another close associate — have recently decided to take a tough line, but their bluff is being called. The place where the most immediate and direct challenge is being launched is in the Chechen Ingushetia republic, in the north Caucasus area, and here the Russian government has issued ultimatums over the last couple of weeks, and the ultimatums have simply been ignored. Except that

#### 4 Seminar on the Soviet Union

they've actually stimulated the independence movement in that area, which is descending into anarchy, and certainly the prospect of Russia being able to reestablish control over that region appears to me to be remote.

Another flash point is Tatarstan, the Tatar republic, where they're likewise forming a national guard. There's a national guard of 15,000 in Chechen Ingushetia. Ingushetia now moves in the same direction as Tatarstan. And all this is leading, as one might expect, to a terrible round, and deepening round, of backbiting and recrimination within the Russian administration itself. Khasbulatov, the chairman of the parliament, attacks Burbulis. And Shakhrai, another leader accuses. Shakhrai replies and accuses Khasbulatov of suffering from a nervous breakdown. The vice president of Russia, Rutskoi, attacks the head of the Russian KGB as being, "lazy and incompetent and a danger to the State." Saburov, the economics minister, resigns at all the disarray. The deputy prime minister, Gavrilov, resigns. Stankevich, one of the leaders, attacks Boris Yeltsin for failing to run a cohesive government, for going off on holiday for a couple of weeks when things are getting into serious disarray.

There's just an endless and, indeed, a mounting series of these sort of attacks. So the Russian government has very little prospect of pulling itself together. The public attitudes in the Russian Republic are getting worse. Sugar riots in Perm recently is just one indication.

Yeltsin obviously hopes to try to pull things together with his reform plan announced two days ago. This has radical economic elements to it which Doctor Aslund will undoubtedly talk about. The political framework that he proposes is one which would require central executive powers to be given to him, Yeltsin, in order to crush opposition to the reforms. I think this will provoke tremendous debate and opposition within the Russian parliament and within the Russian public, and even if he manages to force them through, I don't believe that he has the necessary levers throughout the Russian Republic to carry out this reform. And I think it is doomed to failure.

I've already referred to the situation in some of the autonomous republics. I think it's similar in many of the regions. And then you have the question of political culture. Russian political culture is not ready for radical economic reform, and that alone would defeat Mr. Yeltsin's reform program, I fear. To quote Leonid Abalkin, one of the leading Soviet economists, who said, to try and dampen euphoria after the coup, he said, "This country hasn't changed. The people remain as they were a month ago, with the same culture and the same psychology. You can't change in the course of a month. It takes decades, or at least a generation." I think that is accurate.

What about the future then? Abalkin said, more recently, that drastic action would have to be taken in a cohesive way in the immediate future. Otherwise, there would be disintegration leading to complete and uncontrollable collapse. He thinks the nadir would be reached in the spring. I think that's the right sort of terms to be thinking about the immediate future in the Soviet Union, in what's left of the Soviet Union.

Everyone is terrified about the future, and like drowning men, they naturally clutch at whatever straws they can find, and one of those straws is the notion of help from the West. They will pretend, in order to try and obtain help from the West, that there is much more unity, much more cohesion than is in fact the case. And Gorbachev is a past master at this sort of bluff. The only hope, in my opinion, is for us in the outside world to work with the only source of true legitimacy, which is SOME of the union republic governments. We should expect enormous turmoil, both in the political and economic spheres; we should not hope for any cohesiveness by the center, even on the distribution of emergency aid; and we should prepare, with the republic governments, for emergency aid to them, the more reliable

ones at any rate; and quietly, we need to prepare for massive influxes of refugees coming out of the Soviet Union. Obviously, we don't want to advertise that; it will only stimulate the flow.

The West's role, however, in all of this is going to be rather limited. Enormous processes are at work in the Soviet Union. We can only hope to affect these processes at the margins, and if we think otherwise and try and throw our weight around and impose ourselves, we will very quickly be taught how foolish we are. Thank you.

*Larry Summers*

Thank you. And now for a cheerier note, I hope [laughter], Professor Aslund.

*Anders Aslund*

Well, Mr. Chairman, I'm afraid that I will make you somewhat disappointed in that case. Perhaps I'm somewhat more positive on the situation in the sense what can be done but certainly not in the assessment of the situation. I follow very much what Professor Reddaway has said.

I've been trying here to sort of set the agenda of the economic problems, trying to avoid going into economic strategy or interrepublican relations that will be discussed by other people later on. What we are seeing now in the Soviet Union is very much an interconnected crisis and leaving the political and national crisis aside, that Peter Reddaway have already discussed, we have a systemic crisis, we have macroeconomic imbalances. Because of these two, we have severe economic decline, we have a debt crisis and we should have social unrest, of which we have seen surprisingly little so far. Looking more into these various factors, the systemic crisis--as far as I can understand it now in the Soviet Union--essentially the old system functions out of sheer inertia. The commands are not really given any longer but are more or less invented by the people who want to obey commands. And therefore everything goes on for another while. If you ask people why do you go to work, they can't really come up with any good answer. It's more a question of inertia: What should we do otherwise? It's not that it's necessary economically. They can skip work and earn more money in another way. It's just going out of inertia so far.

It's not likely that this situation will be sustained. Therefore, of course, the big question is how can a new system be imposed as fast as possible. While the government has decentralized, say, 40 percent of prices, retail prices, a bit more of wholesale prices (this is very unclear) you get different figures in these regards. The people who really take the opportunity are the private and cooperative sectors, accounting for more than one-tenth of GNP now. You have a buoyant new capitalist sector growing in the Soviet Union, but it is very small and it's also very distorted by illegal practices. We have a full Mafia system developed, at least in the big Russian cities.

On the macroeconomic imbalances, it seems now according to the best calculations I've seen done by Serge Aleksashenko and Yevgeni Yasin, that the consolidated state budget deficit was 188 billion rubles during the first half of this year, that is 23.5 percent of the GNP. These figures are higher than most figures you see because normally people do not take all the budget deficits into account. We have deficits in the union budget, in the union stabilization fund, in the union pension fund, and then we have deficits in the republican budgets, in particular in the Russian and Ukrainian budgets and all the central Asian republican budgets but not in the Baltic budgets, for example, which did away with their budget deficits already before, and there are no deficits at local levels. For example St. Petersburg doesn't have

any budget deficit. While we also have an awful lot of writing off of loans to collective farms, and the budget deficit is increasing. For this year social benefits were raised very sharply, while the novelty of this year has been that tax revenues have collapsed. During the first quarter only 38 percent of the planned union state revenues were collected. In September this was down to 15 percent. This situation is somewhat better at republican level, but not much. And this has a lot of bearing on what can be accomplished in order to ameliorate the situation. So the consolidated budget deficit for the year as a whole seems likely to end up in the range 25 to 30 percent of the GNP, which is of course enormous. Because of the deregulation of prices, a lot of inflation is coming. It seems that it will be 200 - 300 percent in actual recorded inflation for this year, but the figures vary a lot. And there isn't really any good statistics. This is a situation of extraordinary macroeconomic imbalances.

I should discuss money creation also. If we take cash, at the beginning of this year there was 133 billion rubles in circulation. On the first of July, approximately 150 billion rubles. The projection now for the end of the year is 230 billion rubles. The reason why there was not more money creation during the first half of the year is the price reform, or price revisions of April 2, which eased the budget deficit for a while.

What concerns the economic decline, the official forecasts for 1991 are now 16 to 17 percent. I would argue that there is still considerable hidden inflation in these figures so that we should count with a declining national income of 20 percent. If you look upon GNP figures, they are a couple of percent better, but that is because in the GNP you have public services that are measured on the input side. So I'd rather prefer to use the national income figures as more accurate for the dynamics of the situation.

What concerns the debt crisis. I would say that, that has come about surprisingly late, and this is a theme where we see Soviet control, central control, having been maintained longer than one would have expected given the general economic situation. And this has essentially been done in the Ceausescu manner by cutting imports, which were down by 48 percent during the first half of this year. And I see the OECD projection for the year on the whole is a trade surplus of 5 billion dollars with the OECD area.

But the debt crisis is still coming because Western banks don't trust the Soviet Union now as a borrower, and here I think that we should believe Grigory Yavlinsky's figure of Soviet gold reserves having gone down to 240 tons. Grigory Khanin, from Novosibirsk, who works with us, came up with a figure 500 to 600 tons in reserves at the beginning of this year. So that is alternative statistics that can be used to support the Yavlinsky figure.

Well, this means that in order to ameliorate the situation, it's necessary to undertake fully-fledged macroeconomic stabilization, eliminate the budget deficit, and that can only be done by liberalizing the prices. So this very much suggests a Big Bang, a comprehensive systemic change and stabilization. For that you need a strong government. And for that you need a government that is legitimate in two senses, that it has a national legitimacy, that it has a democratic legitimacy, as we have seen from Eastern Europe.

Let me then just look briefly at the situation in the main part of the country, but first of course I must discuss the union after all. As Peter mentioned, there was the economic union treaty being signed on the 18th of October, and it's typical that only eight republics actually signed it. And these were the five central Asian republics, Russia, Byelorussia and Armenia, Armenia very clearly stating that this was to be considered an economic union only. And here we have Russia that had a big feud about it. The person who originally put his name under it, on the 1st of October, was Yevgeni Saburov, the deputy prime minister and minister of economics of Russia, who was then rebuked by other members of the

Russian government that he had appeared as an individual and eventually just supported by president Yeltsin, which clearly suggests how weak the support for this economic union treaty was from Russia.

The important point here is that the economic union treaty suggests one currency, coordinated budget cuts, and coordinated price liberalization, and for reasons that Peter Reddaway suggested, I would argue this is impossible. This can't be undertaken by the union. The economic policy makers at the union level, led by prime minister Silaev, or what should we call him, and Grigory Yavlinsky, are simply irrelevant, and it's typical that Silaev was sacked from the Russian government by president Yeltsin. Therefore he became chairman of the interrepublican economic committee. Yavlinsky alienated himself from the Russian government structures when he was in Cambridge, Massachusetts early this summer and did not contact the Russian structures at all, although he appeared as the representative of president Yeltsin. The Russian government won't forget that.

Instead what we should look at is who are the economic policy makers at the republican level. Not least because the West has looked so much upon the union, the republics have not felt the responsibility to really push the issue of policy and instead got bogged down into very petty strifes at their own level. President Yeltsin's statement here two days ago might have shown a change. What we have seen in the economic field in the Russian government has been a competition between at least two camps, one around the state council headed by Gennadi Burbulis with Yegor Gaidar as the chief economist, the other with parts of the council of ministers with Yevgeni Saburov as the chief economist. And these two camps have essentially stalemated each other, so no decisions, no appointments, nothing could be done. Now, hopefully, Yeltsin has given the Gaidar group the possibility to carry out the policy, which will be very much shall we say on the Polish line: full price liberalization, full elimination of the budget deficit, an orthodox stabilization and liberalization. So here I would argue there is hope, and the people in this group--it's Yegor Gaidar who's now supposed to become the Leszek Balcerowicz of Russia, deputy prime minister and minister of finance--though he is not appointed as yet. It's the minister of labor, Aleksander Shokhin, with Konstantin Kagalovsky and this group, Anatoly Chubais from St. Petersburg, these are very much a new generation, mostly 38 to 40 years of age, all speak English, most have some Western education. These are the best economists the Soviet Union can show at all, and now they are coming to the fore. So therefore I see a substantial hope that these people can do something constructive. But it's very late in the day, and still we haven't seen that they have got a mandate.

In the Ukraine, nothing can be done, really, on economic policy before December 1, with the presidential election. A new president, whoever he will be, will have to dissolve the parliament, I'd assume, which will mean that two to three months will go before any policy can be formed in the Ukraine. So say the Ukraine can only really strictly have an economic policy by March. And Byelorussia should be able to follow the Ukraine, so to say, rather smoothly and probably more elegantly. While in four Moslem republics we see utterly conservative dictatorships. In two Moslem republics we see authoritarian enlightened dictatorships. Leaving Moldavia and Georgia with rather messy governments, as far as I can see, without any economic policy or economic policy making capacity, while Armenia seems to be a relatively nice, democratically oriented government. And whatever comes out of this, it will be very messy. The main point to make now is really that the West, including the World Bank, needs to turn to the republicans and put pressure on them to pose the hard questions. Right now I see very great hope with this new Russian government that should be able to do something, although I suspect that on balance Peter Reddaway might be right in suggesting that I'm too optimistic because of the political complications. But there is a possibility and it is important to support it. Thank you.

*Larry Summers*

Thank you both. We should move to a general discussion of these points. Let me see if I can summarize the messages that I think have come from this so as to provide a basis for that discussion.

One, the union is dead, so are attempts to act from the center. They will fail, and the West is making a mistake to be investing heavily in them. Second, the economy is collapsing, and the rate of decline is if anything accelerating, and unless radical actions are taken, the situation will get far worse before it gets better. Third, the best and maybe last hope for real reform is in the Russian republic, represented by Yeltsin's speech on Monday, and that is—implicit in what was said—that's the effort in which the West should now be investing heavily.

## SESSION TWO: THE ECONOMIC STRATEGY

*Lars Jeurling*

... going to deal with the economic strategy and I would say that after these rather daunting prospects that we heard in the previous session that is quite a challenge for the three—for the two speakers and the one commentator. I don't think any of the speakers need much of an introduction. John Williamson will speak first, and he's a senior economist at the Institute for International Economics here in Washington, as I think you all know. And he has published widely on the Eastern Europe and most recently with Oli Havrylyshyn on the Eastern European community.

Then we will have Dr. Nuti, who is a professor of economics at the University of Siena in Italy. He's now an advisor to the EC Commission, and he will be the second speaker.

And then, Dr. Weitzman is a professor of economics at Harvard, and he will provide some comments after that.

So, please, Dr. Williamson.

*John Williamson*

I think there's rather general agreement that the economic collapse in the Soviet Union has got to such a point that there really is no sensible alternative but to have a comprehensive and quick reform. And in the circles in which I move there seems to be an unusual degree of agreement about the content of the reform that is necessary. I don't know if this just means that I've finally been absorbed in the establishment, the Harvard-World Bank establishment, as my former classmate Pedro-Pablo Kuczynski described it in the *Washington Post* two weeks ago, on the same page where I wrote about the case for a payments union. (Perhaps that means he has managed to avoid being absorbed in the establishment like me.) But, apart from Pedro, there seems to be a great deal of agreement that a lot has to be done at once, and a great deal of agreement also on the substance of what needs doing. I take the particular taxonomy that Stan Fischer used when he talked about these things in town a month or so ago, because it is representative; I detect little substantive disagreement on these issues among most economists.

The first heading is macroeconomic stabilization. The key is fiscal discipline, i.e., a balanced budget; imposing hard budget constraints on enterprises to prevent them from borrowing automatically from the banking system is an important supplement to that.

The second heading is price liberalization. It is usually argued that this needs to be almost universal. One commonly recognized exception covers a limited range of consumer goods, though most economists argue that, if an attempt is to be made to protect consumers, it would be better to ration limited quantities of a very limited basket of goods, rather than to keep down the price for all goods of specified types. The other big exception that people recognize concerns fuel and energy. Once again it is argued that you would get the incentives better at the margin if that was done through a scheme where enterprises were entitled in the first year to buy, say, three-quarters of their previous year's purchases of energy at the old price (or a much subsidized price), and then the concession was reduced to 50 percent in the second year, 25 percent third year, and phased out in the fourth year, so ameliorating the short-run distributive impact of higher prices while getting the incentives right at the margin from the start.

The third heading concerns how enterprises are managed. This means moving to enterprise autonomy in the short run, followed by privatization as quickly as is administratively feasible. A month ago there was talk about how privatizing army trucks could be a useful emergency measure to help improve the distribution system, which is a big part of the food problem.

The fourth heading concerns a social safety net, meaning primarily unemployment insurance but perhaps also food rationing as a legitimate part of such an exercise in the short run.

The final element is opening up the economy on current account, requiring a unified and competitive exchange rate, current account convertibility and the abolition of at least quantitative restrictions on trade. It does not necessarily imply trying to get close to free trade in the short run, but certainly one should get rid of the quantitative restrictions.

It is important to implement this sort of package simultaneously. For example, a price system needs price stability to be able to function efficiently, but fiscal stabilization is not feasible without price liberalization to eliminate subsidies. So macro stabilization and price liberalization must be done together. Enterprise autonomy needs to have liberalized prices, for otherwise the hard budget constraints that are one of its key ingredients may make the wrong enterprises bankrupt. On the other hand, you can't liberalize prices without hard budget constraints or you just invite a wage-price explosion, so simultaneity is again necessary. Price liberalization needs external discipline given the degree of monopoly in the Soviet Union, hence one has to open up to trade when prices are liberalized. And convertibility is not feasible prior to macroeconomic balance. This is the logic for thinking that these things ought to be done simultaneously. Even those of us who have argued that the object should be to identify the minimum feasible bang would say that it has to be a pretty big bang in this case.

After the coup in August I suppose most of us hoped that at last something decisive might be done to move in the direction of such a program. But we then saw action being paralyzed by a long constitutional debate and the attempt to negotiate a new union treaty or a successor to the union treaty. This raises the question: Who is it that should be implementing these reforms? And I have worried that the West appeared to be backing the wrong side in that debate, the side that was trying to maintain a union. When I prepared my remarks I thought I was going to be far out on a limb in saying this today. I discover I'm once again part of the establishment. [Laughter.]

Why would it be a mistake to rely on the union at this stage? Because the maintenance of any sort of union is not going to be compatible with the national aspirations that have been unleashed by the failure of the coup, the breakdown of the central authority and the end of the world's last multinational empire. There is not going to be any legitimate central authority able to organize a coherent economic

program. This contention seems to be confirmed by the new treaty, which was reportedly signed by a number of the republics, but which is ambiguous on all sorts of crucial issues. It is not, for example, clear whether the new economic community is supposed to be a country or a community in the sense of the European Community. The treaty tries to have it both ways on currency, by speaking of the possibility of republics having their own currency as long as this does not interfere with the operation of the central currency. It implies fiscal commitments that just don't look credible, and therefore invites the perpetuation of the common central bank which finances any of the budget deficits around -- the worst system you can imagine, as Larry Summers has said. And it even tries to have it both ways on membership in international organizations, on which it says the community will be a member of august institutions like the World Bank, but if the constituent republics want to be members too, that's fine. (It may be fine with the Soviet republics, but I doubt if it would be fine with the World Bank!)

So what has come out of this long constitutional debate appears to be something that is not viable, yet was paralyzing progress. Then on Monday we had the announcement by Yeltsin, in which it looks as though he finally took the plunge and signed on to something very like the set of reforms that we Western economists, with the somewhat vague but nevertheless general support of the Soviet reform economists, have been advocating. Most of the program is there: there is certainly a commitment to fiscal stabilization, including the promise of a value added tax (which has to be a key element in getting the fiscal system back in some sort of balance). Then there are promises of general price liberalization, and of enterprise autonomy with a lot of privatization very quickly. Of course, 50 percent privatized by the end of the year may mean that 50 percent of the number of enterprises will be privatized, weighing shipyards equally with corner stores, so it probably doesn't mean as much as it sounds, but nevertheless it sounds pretty dramatic. A social safety net is also mentioned. The one thing that is absent is a commitment to opening up the economy. While many of us would regard that as pretty dangerous, its omission is probably a lesser evil than the omission of any of the other elements.

In my judgement it would not be feasible for any union government to put through such a program at this stage. The question is whether it is feasible for the Russian government to do so, and I'm less well-placed to judge that than the speakers in the first session. Let me just ask whether government legitimacy is as key an element in a program that liberalizes -- whose basic purpose is to get the government out of things, rather than having it take the initiative -- as it is in some other types of programs. If the old system carries on by inertia for a while and simply gets chipped away more and more by enterprises deciding to exploit their new rights, I don't see that need necessarily be fatal to the program.

What are the policy conclusions as regards the West at this stage? Clearly the West can't be seen to be pushing for a breakup of the union, but it should recognize that it's happening and the emphasis should be on trying to make the successor states successful, trying to help them reform successfully. That, to my mind, is going to include not just technical advice and financial support in introducing the sort of program that I went through a moment ago, but also there has to be a crucial role there in encouraging continued cooperation in maintaining free trade among the republics -- or perhaps one should say in establishing free trade among the republics. In particular, we need to create a financial mechanism capable of supporting trade in the short run, which is where a payments union seems to be a very natural candidate for support.

Two other issues that came out of the earlier discussion. I wonder whether it would be appropriate at this stage for the West to try and help avoid further splintering of the republics by declaring a moratorium on recognition of new units after the fifteen republics achieve independence? That's essentially saying: Ten years on, we'll consider the claims of the Tatars and so on and so forth; but for now, that's it. Could that help?

The second issue. When Russia moves to charging for oil at world prices, and I think it's a question of when and not if, what is going to be done to help the oil importers who are most adversely affected in the short run? Is the West going to be willing to provide some help, or are we going to expect the Russians to give time for adjustment, or are we planning to sit by with folded hands?

*Lars Jeurling*

Thank you, John. I think you've confirmed what was said this morning, that they're a long way from a viable strategy for the Soviet Union but I think you're also saying that they — if there is a chance that it probably is in the Russian republic. I think that was also what was discussed this morning.

So Doctor Nuti?

*Mario Nuti (Commission of European Communities, Brussels)<sup>1</sup>*

Last year the European Community published a report on European monetary unification which was entitled "One Market, One Money." Last December, when the Community report on the Soviet Union was published, it was suggested that a good title might be "One Market and No Money." This, however, seems a much better statement for conditionality of Western aid: "No Market? No Money." [Laughter.] The importance of the monetary stabilization in the Soviet Union cannot possibly be understated.

We should distinguish between the achievement of market-clearing prices and stabilization in a stricter sense, i.e., the achievement of market-clearing prices without excessive inflationary pressure and with sustainable trade and payments balances. Clearly stabilization is a desirable objective but a primary task by itself is the achievement of market clearing prices at a single level. This particular task has nothing to do with the transition to a new system; it is an essential precondition for the viability of any economy using money and "markets," such as the Soviet Union has been even at the height of Stalinist rule, even if markets are used as a limited instrument of distribution (of consumption, labor, materials) and not as a full instrument of resource allocation. Market-clearing prices would still be needed even in the absurd hypothesis that the Soviet Union, instead of progressing toward a market economy with private property and enterprise, wished to go back to central planning.

Market clearing conditions are very easy to obtain, through alternative combinations of demand contraction (lower deficits, confiscatory replacement of the currency, higher interest rates, taxes), supply increases—presumably in the short run coming mostly from external grants and loans rather than domestic sources—and higher prices. This operation costs nothing in terms of total consumption, because market clearing does not reduce the level of consumption internally available; indeed it may raise it through external assistance conditional to price liberalization, and through some supply response of private agriculture. It only has probable adverse effects on the distribution of income and wealth, but these can be tackled through taxation and income support.

The reason why such simple and costless operation has not been undertaken by communist governments is their concern about the political implications of price rises and distributional effects. Thus there has been a blind commitment to official price stability in spite of a monetary explosion whose

---

1. The views expressed at the Seminar do not necessarily reflect those of the Commission of European Communities.

effects were as uncontrollable as the nuclear explosion of Chernobyl's nuclear explosion. Price rises to market clearing level have been regarded as not politically feasible; yet the implications for the leadership and for the country of not restoring market balance have been much worse than those of taking unpopular measures. Currency degradation through repressed inflation has brought about intolerable endemic shortages, the disruption of supply lines and consequent output decline, the disintegration of CMEA and of the Union itself.

The good news is that market clearing and stabilization can be done at the republican level, through the introduction of republican currencies. Anders Aslund has stressed how even the republican leaders who have announced a new currency fail to understand this might actually mean and imply. I can visualize only one sensible way of introducing a republican currency: namely, the overnight replacement of a limited quantity of rubles with a new means of payment which is made the only legal tender inside the republic, under a set of necessary conditions. Beside printing and minting the new currency—which is as far as some republics have got to until now—republican authorities would have to announce an initial rate of conversion between old rubles and the new currency for wages, for extant contractual obligations and for liquid monetary assets. This conversion rate would have to be uniform; it could be diversified by amount, type of monetary asset and by categories of holders; this could take care of undesirable effects on income and wealth. The conversion would have to be limited to fixed amounts of ruble assets, in order not to be simply a change of numeraire, and presumably limited to nationals or preferably to residents, in order to avoid a flood of rubles from other republics.

At that point, prices in the new currency would have to be left entirely to the market. They would have to be liberalized; otherwise the system would be overdetermined and we would be back into the old system. The new currency would have to float with respect to the ruble because, if there was a fixed rate of exchange and the new currency was managed more wisely than the ruble, Gresham's Law would come into operation and the good new money would be driven out of circulation. A floating rate would allow the ruble to depreciate over time and to continue to be used as means of payment, but only between consenting parties and not as legal tender.

Other republics could follow. One only wishes they did not call their currencies fancy names, like the Ukrainian Grivna, the Kazakh Altyn (or Tanga, or Som, which are names still under consideration), the Estonian Kroon, Latvian Lata, Lithuanian Lit, as if a Slovenian Tollar and a Croatian Dinar on the way to become a Croatian Kroon were not enough. Of course it would be more convenient, mnemonically, to continue to call them rubles named after each republic: the Ukrainian ruble, the Kazakh ruble, and so on.

The advantage of introducing republican currencies is the ability to stabilize, privatize and open trade unilaterally by republic, without waiting for Union-wide consensus—at a cost, given by having to raise by a factor of five the reserves necessary to support convertibility of fifteen different currency. A major implication is the shift of ruble overhang onto the other republics, raising the intensity of the overhang and the equilibrium price level there. Once one republic does it, there is an incentive for each republic to do it as soon as possible in order to anticipate the others. When this is done by the fifteenth republic, all residual rubles are effectively confiscated; they are not a claim on any republic's resources and become good only for papering walls. The end result is exactly the same that would be obtained for a Union-wide confiscatory replacement of the ruble.

The paradox is that the confiscation of the currency as a possible solution for the monetary overhang, regarded as very unpopular and politically infeasible at the Union level, should be perfectly acceptable if implemented through the introduction of republican currencies. One might have thought

that, on the contrary, it would be preferable to shift the odium associated with such a confiscation onto a central government on the verge of collapse, rather than saddle new republican governments with that particular source of unpopularity.

Once, one way or another, market balance is achieved, the other tasks of the Soviet economy have been very well illustrated by John Williamson. These are stabilization in the stricter sense given above, transition to an internationally open market economy, privatization, the restructuring of inappropriate capacity. When, in the autumn of 1989, the new Polish government faced all these tasks at once there was no precedent and therefore it was natural to proceed from first principles and, because of the underlying hyperinflation, to look at the experience of stabilization plans of Latin American countries in spite of their poor performance.

Today it is no longer justified to search for a desirable economic strategy for the Soviet Union still starting from first principles and looking at Latin America. We should learn from the experience of the stabilization and reform programs of Poland (1-1-1990), Romania (1-9-1990), the CSFR (1-1-1991), and Bulgaria (1-2-1991). We should also look at the failure of the stabilization program of Yugoslavia, whose republican disintegration is particularly relevant to the Soviet Union. We should also learn from the mistakes made in the Soviet Union in this period, such as absurd prior announcements of price increases or confiscation of large denomination bank notes. We should also look further East, to the experience of Vietnam, China, and South East Asian countries.

There are positive and negative lessons to be learned from these experiences over the last two years; some will be controversial, but they are still worth considering. We have learned that economic austerity requires political legitimacy, as Anders Aslund has stressed, although democracy brings about the danger of populism. We have learned that stabilization can bring an instant end to shortages through a large but tolerable hike in prices, after which later inflation can be brought down; that budgetary restraint and monetary discipline are indispensable, otherwise the round of price increases involved by stabilization is wasted. Because of the underdeveloped monetary and financial system, monetary policy is not enough to sustain a stabilization program; a wages and incomes policy, preferably enshrined in a social pact, is also necessary. Also, farmers' incomes should be protected, not just because they are protected everywhere else but because of the importance of supply response in agriculture.

We have learned that internal convertibility for current transactions is much more within reach than previously thought. We had forgotten that the difficulties experienced for instance by Britain in re-establishing convertibility were due to large external balances in domestic currency held abroad. Such balances are not present in the case of today's transitional economies, so it is much simpler to establish convertibility for a country that starts from scratch. There is of course the question of foreign debt, i.e., large balances in hard currencies held abroad. Thus we have also learned that it is fatuous to talk about convertibility unless there is a period debt rescheduling, whether agreed or unilaterally declared, or debt relief. Capital account convertibility, on the contrary, is out of the question for some time to come.

We have learned that some underdevaluation of the currency is necessary to establish credibility, but that the ruling black market rate or the limited free rate (for instance at currency auctions) is an excessively low rate at which to establish convertibility. When the exchange rate is used as a nominal anchor, the currency then tends to appreciate with domestic inflation to the point of subsequent overvaluation, leading to further rounds of devaluation and inflationary shocks.

We now know, on the basis of recent experience, that unpopular measures should not be diluted, but taken all at once if possible. A weak indexation of the whole money wage, as in Poland, leaves real

wages to the vagaries of the success or failure of government anti-inflationary policy; real wages, brought down by inflation, then have to go up again and this revamps inflation. It is better to have a real wage policy and, instead, have a strong indexation of a very low level of real wages (as in Bulgaria). Aiming at a positive real rate of interest at once may be costly in output response; in any case interest rates should not be raised on existing loans as it was done on Poland because this is a tax on liabilities which nobody every dreamt of imposing. The government must have some contingent plans, not just have one plan which then has to be executed regardless of domestic and international developments for fear of signalling policy reversals.

A major lesson concerns privatization: there is consensus about its desirability but we have learned that it takes a long time to privatize state assets, except for small scale privatization of housing, restaurants, shops and plots of land. There are no shortcuts to privatization: one can accelerate the transfer of ownership titles through "voucher" privatization, i.e., the free or subsidized distribution of shares to the population, but this is ineffective in that it does not establish the structure of incentives associated with private ownership, because of missing efficient financial markets, illiquidity of such securities, lack of corporate control. Moreover, even the time taken by free distribution of state assets has been grossly underestimated, for instance in Poland and the CSFR where it still has not taken place.

There are two important corollaries of the time-consuming nature of privatization. First, stabilization cannot be mixed with privatization (as the aborted Shatalin-Yavlinsky 500 days plan intended instead): to rely on mass privatization in order to help the stabilization process is an absolutely certain recipe for procrastination and failure. Second, in the necessary delays of privatization we cannot simply pretend that state enterprises are no longer there: state enterprises still need a reshaping of managerial incentives, reorganization and restructuring and the resources necessary to implement them. It is unfortunate that the idea that the state sector is important should have become associated with nostalgia for the old system, whereas even Sir Alan Walters, Margaret Thatcher's main economic adviser, said in Bangkok that the Soviets were giving too much importance to ownership and not enough importance to how their enterprises are run. The simple recognition that a large state sector continues to exist and will be the dominant sector for some years to come should not be misunderstood and confused with advocacy of the old system.

Finally, we have learned that there are very high costs involved in the transition (unlike the costless nature of market balance). Many of these costs are the delayed manifestations of the costs of the old system. Some of the costs are the result of the collapse of intra-ex-CMEA trade and of national disintegration by regions. Some costs are geared to transition as such, to be considered as a kind of investment in reform and restructuring, which should give a very good yield in the future. However some of these costs are avoidable and are the results of mistakes that really ought to be recognized. It is alarming that there should be the same degree of complacency and cosmetic manipulation of data on the part of some leaders and some of their advisors in central and eastern Europe today as there were with the old leadership, and the same inability to learn. I hope that our discussions will contribute precisely to learning from the recent past. After all, true wisdom is learning from other people's mistakes before having to learn from one's own.

*Lars Jeurling*

Thank you very much, Doctor Nuti. You have told us that we should look at the experience in eastern Europe in particular, and one question we may want to raise is how conclusive is that. After all, eastern Europe is not out of the woods yet. So this may be something you want to discuss. Martin Weitzman, you're going to give some brief comments.

*Martin Weitzman*

Yes, I will try to be brief, among other reasons because I don't feel that I have very much of substantive interest to say.

I had thought in conceptualizing what I might chat about that there'd be a situation like the following: there were be a bunch of economists — well, there are, primarily — there were a sort of naive or gung-ho tone to what is going on. And I would be the one who would read a short lecture on why Russia or the USSR or whatever it is is different from Poland, Hungary or Czechoslovakia, and it's not just different but it's sort of an order of magnitude different in my opinion, and it's as different from them as they are from Great Britain or the United States in terms of the problems that are faced. And that Poland for example is compared with Russia or the Soviet Union or whatever we should call it as a model of clarity, simplicity, unanimity in what is being done [laughter], and that's the right way sort of to be looking at what is going on.

But that lecture has been read in the first act here, and I don't propose to push that line much further. I think the key phrase here is one that Peter Reddaway used, that no one is in charge, or it's very hard to find who is in charge of economics or economic policy or whatever. Words are mouthed in the Soviet Union for sure; Russians are never at a loss for words. Acts are passed, decrees are passed, they are rescinded sometimes. It's not clear who is reading these things or how they are enforced anymore or whether they make any difference. There is an Alice in Wonderland quality about the whole thing that makes so-called eastern Europe look very different to me anyway.

Now, attempting to be constructive, what — I ask myself — what is the — if you have to compress the message to be given to them presuming that there is some listening, what might the message be of the World Bank or the international community?

Well, of course, there's all the stuff about reforms that is like Poland or Czechoslovakia somehow, and of course there are lessons from all that. This has been pointed out because in some vague sense there's a very similar set of issues involved, there's an attempt to make a transformation from some form of socialism to some form of capitalism. There's bound to be some overlap and some relevance.

But I would say the most immediate message to be given — I don't know if it would be listened to by the World Bank, by the IMF, by U.S. Fed, by whomever — is that you really have to get your act together and make well-defined what you are doing in the three critical areas of (1) currency banking, (2) taxation, spending, budget, and (3) exchange rate regimes, convertibility payments—whether between republics or with republics—and the outside world or between the union and the outside world.

That I would say really at this stage is the major message. Even if you solve this sort of thing there are plenty of headaches down the line, but this one really has to be dealt with.

There is this again Alice in Wonderland aspect which I don't fully understand. Some of it — some of the symptoms are — we've heard, sort of own-currency mania or maybe somebody can think of some other term for it. Wherever you go or whatever they want their own currency, and the next thing is what does it mean anyway, but we want it for sure. We want our own stock market of course, for sure. Again please explain what that means or what it does but we certainly want it.

I think that's symptomatic. And the message really has got to be that — and maybe there's some hope if it's spoken with one voice although I wouldn't put great hopes on it — that, look, you have a choice in a nuts and bolts fashion of what kind of regimes you want to put in these three critical areas. You know, I don't know but somebody could research this — there are three and a half successful examples of federation in world history. And there are eight — the following eight and a half different currency regimes which history has shown to work. And so forth. But you have to make a choice. You really have to choose among these things and you have to stop straddling, stop trying to be a convex combination of all things to all men. These various regimes have various advantages or disadvantages but you must choose one of them. You have to get off the fence if you're to have any hope at all.

And as far as this nationalities and this other stuff, look, the world is full of big poor countries and big rich countries, and the world is full of small rich countries and small poor countries. And somehow in the economic scheme of things, sort of in the broad sweep, it probably doesn't make a hell of a lot of difference how this thing is structured, compared to some problems that we've spoken about. But it's really got to be structured and you've got to move on from that. The current structure is extraordinarily vague. Now, we have to see what comes out of this Yeltsin stuff. It looks like kind of a step in the right direction to me, but if the past is any guide to the future, it will also be alarmingly vague, maybe not quite so alarmingly vague, but that's my guess that it will remain alarmingly vague.

So I think the constructive message if there is one to be given is — is what I just enunciated. You really have to make up your mind among a relatively narrow list of regimes in these possible areas. You have to pick one, you have to sort of implement it, and you have to go through with it.

Now, of course it's tied up with other reforms, but really then we can start to talk about reforms. There's going to be no reforms of any meaningful sense, there'll be no economy in a meaningful modern sense, there'll be no country perhaps in a reasonable modern sense until some — something specific and concrete is chosen on this front. Now that's the main message I think that the Soviet Union or Russia should be getting. Not so much these other things although of course they're important too, and they'll be down the road.

*Lars Jeurling*

Thank you very much. We have now about 25 minutes for questions ...

### SESSION THREE: INTER-REPUBLIC RELATIONS AND TRADE

*Alan Gelb*

This session is on inter-republican issues, general trade in particular. I don't think we need to remind ourselves how important this issue is, in fact, in a way we've been discussing it all morning to a greater or lesser extent. So in a way we are picking up and going deeper into this very critical area.

We have two speakers. On my left is Paul Goble, who is special advisor on Soviet nationality problems in the State Department, and he is an expert on the Soviet republican and nationality issues. We're very pleased to have him with us.

And on my right is Stuart Brown, who's a professor at Georgetown, who's also been researching on republican issues, and he's also the director of the Pew Economic Fellows Freedom Program, an initiative to bring people from eastern Europe, Soviet Union for training at Georgetown. So I thought I might mention that; it's a nice initiative. Paul, why don't you take off?

*Paul Goble*

Well, thank you very much. First, I must apologize for not been at the morning session and then I must give you three caveats. The first is that since I do work at the Department of State I want to indicate that what I'm going to say here is definitely my own opinion and is not necessarily that of the department of the U.S. government. Second, if any of you are journalists, I must ask that this be not for attribution, that is, off the record. [rest of presentation omitted at author's request due to confidentiality].

*Alan Gelb*

Thank you, Paul. I think that this may be the first note of hope in the meeting so far. So, thank you for providing us with some relief from [laughter] some of the gloom of the earlier sessions. Ok. Stuart.

*Stuart Brown*

When I think about inter-republic relations and inter-republic trade, several things come immediately to mind, and I want to just list those and to try draw out some of the implications.

The first is that due to the nature of Soviet central planning and for other historical and geographical reasons, Soviet republics are unusually integrated. In particular, the monopolistic structure inherited from central planning makes them extremely dependent upon one another for both supplies and markets. And this very important factor has several implications.

The first is that there is great potential for a rapid collapse in production that can cascade across the entire economic system. Where that threat arises is from bottlenecks ultimately caused by dependence on single suppliers, in interaction with export prohibitions at the level of the republics (which are in turn largely provoked by monetary factors—monetary disequilibrium).

Second implication. The lack of competition implicit in this mutual system of supply dependence, and other hallmarks of central planning means, that there are severe obstacles to the type of quality enhancement that would help integration in the global economy. This then implies, for example, that even if one factory in Ukraine succeeded against the odds in introducing an important process innovation, potentially quality-improving innovation, it still is tied to the technological grid of the Soviet system through its supply dependence on other factories in other republics. Thus, until and when economic reform gains momentum throughout the Soviet Union and becomes generalized the ties to other republics represent at once a lifeline, but also a major constraint on productivity and quality enhancement in that particular Ukrainian factory.

This situation is exacerbated by the remnants of a state monopoly of foreign trade and the trade aversion implicit in Soviet planning, which has left enterprises (and therefore republics) limited access to foreign exchange, little experience with direct trading rights, and the problem of currency inconvertibility.

This means that the ability to trade efficiently and flexibly is very limited, and the financing required to trade at world market prices and hard currency is just not there.

The final implication of this first major factor of supply interdependence is that the viability of such economic linkages is exacerbated by a virtually total breakdown of the GOSSNAB system, the supply system which the Soviets depend on.

The second major factor, it seems to me, involves cultural diversity. Cultural diversity among the peoples and republics produces marked variations in the attitudes towards the market. Even if everyone in all these republics verbally champions the market, these non-trivial differences in culture plus unequal resource endowments, unequal levels of development, will surely produce significant variations in the reform processes and reform programs of these republics (to the extent that they can be isolated).

We should at best expect a significant desire for policy autonomy that reflects not just nationalism but simply different economic, social and cultural circumstance.

This has a further implication: and that is that even if most of these republics succeed in adopting in a general way what John Williamson calls the minimum bang—and I think this is not necessarily a likely scenario—the specific implementation of those measures will surely vary to an extent that coordination problems become very evident. This factor combined with previously suppressed ethnic grievances (which seem to be growing in intensity) would suggest at least to me that the dream of common economic space, or a new economic community in which all customs barriers are dropped and free mobility of factors is permitted, is at the very least a very great challenge to achieve.

At the same time, the first factor I mentioned—economic interdependence—should constrain the willingness of these new states (despite their different notions of economic reform) to act exactly in conformity with those desires to reform in a specific way. Why is that? Because for some time at least the returns to doing that (that is to doing exactly what you want to do in that particular republic) are likely to vary inversely with the degree to which other republics with whom you are inextricably tied, choose to act otherwise. Therefore, if one would-be radical republic—reforming republic—discounts the probability that others will follow suite, the risks of acting alone are very, very great. In the absence of some outside mechanism, some outside anchor (a Western promise of import subsidies conditioned on the achievement of a minimum set of reforms, for example), this could create a situation in which a would-be radical republic becomes in effect a conservative reformer from the fear that it will be isolated.

The third major factor it seems to me that we should be thinking about involves perceptions of past burdens. This is summarized in the phrase Who's feeding Whom, or Who owes Whom. The fact is (whether these perceptions are accurate or not) every single republic in the former Soviet Union believes that they have been ripped off by the system, in fact, relative to all other republics.

This is a very, very difficult problem for an economist to try to resolve, and I would submit, having tried to do it, having tried to look very seriously at the economic statistics, it is almost an insurmountable task. Nevertheless, the perception is that each of the republics has been a net loser relative to other republics. But one of the important factors to consider is that, even if you believe the statistics which the Soviets published in *Vestnik Statistiki* in 1990, which seemed to show basically that Russia was feeding everyone else, when expressed in world market prices, it is possible that this kind of pattern will change markedly in the next couple of years. In particular, Russia is experiencing severe oil problems, gas production problems. Assuming that demand (energy demand) does not fall precipitously, it is likely that exports will be way down, including exports to other republics. At the

same time, if the needs of Russia for imports of agriculture goods continue to escalate, they will be importing mass amounts of grain from the Ukraine and other republics.

All this amounts to the conclusion that it may not be that Russia will be a structural exporter or creditor with respect to the other republics, within two years.

In any event, we should be very cautious in considering what such trade balances as reported in official Soviet statistics can tell us about the ability of these states to survive over time, as they respond to world market forces with a great deal of changes in prices and quantities.

And the other factor related to this who's feeding whom, of course it's been alluded to continuously today, and that is the Russian federation itself faces the challenge of answering the question who's feeding whom among its autonomous republics

*Questioner*

\* who's feeding whom, you don't literally mean food, grain ...

*Stuart Brown*

The fact is that autonomous republics within Russia are arguing that they are "feeding" Russia as well as the rest of the Soviet Union through large net exports of energy and metals to other parts of the Soviet Union or abroad, providing the foreign exchange with which to import vital goods for the entire country while receiving little of value in return. For these and other reasons there is a big challenge in trying to get those republics to cohere in some sort of Russian federation.

All of these factors lead to a basic dilemma which I want to emphasize. All these republics recognize that a sudden contraction of interrepublic trade combined with some desperate effort to integrate overnight with the world economy would greatly lower output and even be fatal in the sense that an eventual transition to global integration would not be possible, would not happen. But depending on how this interrepublic trade issue (or interrepublic trade) is restructured and financed, short-run trade stability could be achieved only at the expense of a much slower transition to the market and towards global integration. This is the basic dilemma as I see it.

While all republics appear to want and expect to attain greater global integration it is not clear where their long-range comparative advantage is (which depends on history, investments in the future, changes in prices, and so on). But given the current distorted picture, where they will or should go in terms of geographical and commodity composition of trade over the intermediate and long range is not clear. Given this dilemma there are some cogent ideas I would argue in favor of a payments union as John Williamson and Oli Havrylyshyn have advocated recently. I think that the arguments they have made in favor of this union are clear. I would like to raise some possible question marks with respect to that idea -- these are simply questions and not necessarily criticisms -- A payments union, one might argue, (a) could perpetuate certain irrational trading linkages and open new ones that are in effect trade-diverting rather than trade-creating. (b) Will it slow down the move to convertibility? In particular, if certain republics are ambivalent about a steady march to convertibility, will the introduction of a payments union make this less likely or slow it down? If you adopt a payments union, it seems to me that it is critical to impose additional rules which guarantee a gradual liberalization of trade which in turn fosters the desire to phase out the payments union and move toward convertibility.

Let me turn to some processes which are coexistent within the Soviet Union right now which are trying to grapple with this basic dilemma. I don't know which process will win out but I think it is useful to at least enumerate them. One which I don't want to spend any time on is a possibility of another coup. That may well happen if economic conditions worsen but I don't know how to evaluate the prospects of that occurring. So let me just put that on the side as one possibility. Another process that exists is the so-called Tallinn process, that is a process by which the republics get together and do not invite Moscow. They may invite Moscow as a city but not as a separate entity representing a union. I was at one of these meetings. In fact, I spoke at the fourth Tallinn meeting and the impression I was left with was that these representatives of the republics were basically interested in large bilateral barter deals. But when you pushed them on the notion of how to introduce market relations, how to go from what is a very transitional type of situation where you have to deal with the breakdown of the GOSPLAN system and go to a system in which there are horizontal ties between enterprises they really were not very interested in that process or they did not feel it as a big problem.

Another process coexisting we might call the Alma-Ata process. And that process it seems to me represents an attempt to try to renovate the idea of a union treaty but on a very different type of basis. The central question here is: can the center evolve from a planner to an arbiter or coordinator. There are obvious advantages to some sort of coordination, it seems to me. I think we could all enumerate ways in which a coordinator in some abstract sense could help the situation. With respect to price reform, with respect to privatization, with respect to a lot of different important aspects of economic reform. But the idea of reviving any kind of center provokes very different reactions in the different republics for very complex reasons. Some are completely against any role for the center, but for some republics (for example, Uzbekistan) the idea of a strong coordinator-type center still has a lot of appeal, because it tends to legitimate what's going on within Uzbekistan in terms of the consolidation of power. Besides it may mean the return of budgetary transfers to central Asia. In Russia there is confusion over whether a new center is possible or necessary. Some see it as necessary in order to legitimate the Russian Federation itself.

There is another set of issues of which we must be aware of and that is related to the Alma-Ata process—fiscal federalism. There may be strong arguments in favor of, for example, independent taxing power for the center. There are certainly arguments in favor of a single currency as it reduces transaction costs and provides other benefits. One might want to be very flexible with respect to the literature on fiscal federalism in advocating, for example, local control over redistribution and certain things like that, but the point is that there are arguments to be made to justify some sort of fiscal federalist arrangement within the Soviet Union. That is a different process than the Tallinn-type process.

There are other processes at work as well. One is the possible breakup of the Soviet Union into a series of clubs which comprise several ex-republics. Each such "club" or constellation of republics may have very distinct ideas about how to carry through reform or organize monetary, fiscal, and trade policies. Their formation is difficult to predict. That is to say it is a very complex process and it is very difficult to predict the outcome. Yet, we could witness the formation of coalitions which are very difficult to entertain in terms of their specific characteristics right now. The situation in terms of the variation among republics in culture, in reform process, in model of development can interact in such a way so as to produce very unpredictable types of coalitions.

Finally, there could be an inter-enterprise solution which bypasses all these republic-type endeavors. That is the formation of commodity exchanges—inter-enterprise barter/credit arrangements which pay little try to circumvent efforts of the republics to control or direct the situation.

The issue is what does the West do in light of these competing processes. What kind of stance should we take to affect the situation. We are going to be talking about a policy in a little while, but let me just state that I think is a very important consideration which will affect the specific type of conditionality package we try to impose. It is counterproductive, in my view, to condition any aid on achievement of a union, monetary or otherwise. It is also completely counterproductive to condition an aid package on the absence of a union.

There are several reasons for accepting or feeling comfortable with multiple currency outcomes in the Soviet Union. One is that the politics are dictating that. Secondly as a short run defense against hyperinflation, it makes perfect economic sense to introduce your own currency to protect the citizens of your republic. Third, there are optimal currency area-type factors that might justify the multiple currencies. This will add to transaction costs but it also allows individual republics with different industrial structures, different development levels, different degrees of factor mobility to do things such as devalue or revalue, or to use inflation tax to collect seigniorage. I think Havrylyshyn/Williamson are exactly right in bringing attention to the moral hazard problem of a single currency with multiple policy regimes. On the other hand, given the populist impulses in each republic I'm not sure that reckless fiscal policy will disappear with the creation of an own currency. For example, would a Russian central bank really hang tough with respect to a large Russian fiscal deficit? Whatever the specifics of a conditionality package, I don't see any reasonable way around directing attention specifically to the republics as opposed to the union. Under current conditions it is certainly not legitimate in my view to direct an aid policy at the center. There are various ways of directing it to the republics, but that's an absolutely crucial and unavoidable stance we must take.

Finally, we must, and Paul Goble referred to this very correctly, we must get beyond the perception which drives the backing behind the Union solution and that is that a small country, a net energy and material importer, is somehow doomed to disaster if it is not tied to some larger resource-rich entity and allowed to import at less than western world market prices. Everything we know about the underlying sources of productivity growth and the critical importance of correct policy (most critically outward-oriented policies) should lead us to reject this view. This does not negate the need for transitional official and private capital inflow to those republics, and it certainly does not negate the fact that serious terms of trade losses will occur in the short run. Thank you very much

#### SESSION FOUR: MILITARY CONVERSION

*Jonathan Brown*

If we can begin. Military conversion in the Soviet Union is an area of great expectations and great difficulty. At the time of John Wilson's study of the Soviet economy government officials were noticeably reluctant to provide information on the defense industry and the possibility of conversion to non-military production. John Wilson's team did see one example of military conversion—a ship building company branching out into producing skate boards, a product we parents consider as lethal to children as any military weapon.

We believe that there are some five million persons employed in Soviet defense industries which are concentrated around Leningrad and beyond the Urals. The Soviets place great hope in military conversion since these industries have traditionally received preferences in allocation of highly skilled people and material resources. In some areas their output of military products has been of very high

quality. On the other hand, these companies, their managers and their workers are not oriented toward market mechanism for consumer markets. Military conversion in other countries has been a painful and not very successful process. Our two speakers today will try to educate us about the potential for military conversion in the USSR and the republics, and about the possible role of the private sector, and for the international financial institutions.

Steve Meyer, on my right, is professor of political science at MIT, the author of numerous books and publications on the Soviet military and a consultant to the Department of Defense and other organizations on Soviet-related defense issues.

Dean LeBaron, on my left, founded Batterymarch financial management in 1969. He currently manages 6 billion dollars in equity assets and has raised funds from institutions to invest in military conversions in the USSR. He has looked some 100 military companies in the Soviet Union in this process.

Professor Meyer, would you like to start.

*Steve Meyer*

I spent the last two months actually giving talks mostly on the command and control system for Soviet nuclear forces, so I am very happy to be talking about something else (though perhaps no less explosive). The talk that I'm going to give now I sorta' borrowed from what Marty Weitzman said this morning and I call it "Alice in Conversion Land" because in fact much of what people think has happened in conversion in the Soviet Union has in fact not happened at all. It's most a fiction and I'm going to try to describe how it got to where it is today and what is likely to go on in the future.

So let me offer you two bottomline assessments right now. First, very little military conversion has actually taken place in what people are now calling the former Soviet Union. Statistics are given out randomly by the Soviets but they usually say something like four hundred enterprises are converting and the mix of output is changing from sixty-forty military-civilian to forty-sixty military-civilian over the next five years. And that is just nonsense. In fact, probably less than half a dozen plants are involved in full conversion (by that I mean ending military production and substituting it with production line of civil goods). There are probably several dozen plants that are involved in partial conversion, and by partial conversion I am talking about closing down specific lines and putting in civil goods in their place. But there probably are, there are in fact much larger number of plants that are involved in expanding diversification and that means that what these plants are essentially doing is maintaining the military product maintaining the production facilities, but trying to do other things with both residual materials and what is increasingly surplus labor. (Let me talk a little bit about that.)

The second major point I want to make is that a conversion has now begun, but as the skateboard example suggests, it's a conversion to low technology, it's a conversion to very chaotic process of finding almost random goods to produce to maintain activity in a facility, while hopefully some political and economic order descends upon what was the Soviet Union.

Now I'm not an economist, though I do play one on TV every once in a while. What I'm trying to discuss here are really what's happened in the conversion policy and why in fact nothing has occurred. How did we get to where we are? In 1988, a plan was developed—what I would call a systemic diversification plan. It was developed by military-industrial commission (which was a controlling group

that really orchestrated the industrial production of all the major defense ministries, and GOSPLAN, the state planning commission). The goal of that plan was to save the defense lines, and to guard investment and technology both internally and from abroad to expand the technology base of the military production lines into dual-use technology. It was not a conversion plan to shut down military lines and substitute civilian goods. That plan was developed in 1988. The only plants to undergo actual conversion was one missile plant connected with the intermediate nuclear forces treaty, because those weapons were no longer to be produced so the plant was to be converted, and one tank plant of which it was decided that there were too many tank plants in operation and one would be converted. So there were really only two plants that were slated for experimental full conversion. What was supposed to happen among a large number of defense enterprises was diversification of output to dual use technologies such as computers, medical technology, aerospace systems.

There are over a dozen key technologies on the VPK list, and the intent of the military industrial commission, the VPK, was to in fact not just preserve but actually build up its defense technology base. There really was no interest at all in consumer goods in this plan. Well, this plan went no place, because by 1989 we enter into what I call Systemic Diversification II, and that essentially is a presidential override saying: No, we're not gonna do this; we've got a desperate social situation in this country; we are going to produce consumer goods. And the fear of social upheaval both within the Soviet executive branch and within the Supreme Soviet led to a well, I wouldn't call it a plan—that would be too generous—but it led to an order essentially that defense plants should increase the output of civil goods. And the explicit goal of this project was simply to stem the prospects for social unrest, as the Soviet regime came to grips with what happened in Eastern Europe. And so GOSPLAN issued directives to the various defense plants to increase the outputs of pots and pans and toasters and skate boards and shoes and those sorts of things—things that they had always been producing. And in fact these plants tried to do that with the best they could, but in no cases did they or were they ordered to shut down military production and convert. They were merely trying to expand gross output.

Now, many of you may have heard the numbers that in fact the value of civil goods is increasing at individual enterprise relative to defense goods. And that's only because of price inflation, for the most part. And when you ask the question, how could all this conversion be taking place, and indeed how could it be taking place when there's supposed to be increased civil output and yet there's less and less goods available, the answer is what these guys do is double the price of the civil goods—and in fact they cut the quantity and maintain a stable price on defense goods—so the output mix looks like it shifts because the numbers shift, but in fact the gross output is actually declining. In fact, this year gross output of civil goods did decline from defense industries. And so, what you end up having is a lot of blue smoke and mirrors and people asking: well, where are all the goods?

In 1990, we entered a period of rather than systemic diversification, what I call degenerate diversification. And it's degenerate because what happens in 1990 is individual defense plant managers attempt to compensate for the declining defense orders by increasing (sort of on their own—with their own sense of what's necessary) their own civil outputs. And so they're no longer getting orders from GOSPLAN or the VPK; in fact, they're sort of looking around saying, Um, bicycles, bicycles; we could do bicycles; let's—why don't you guys start making bicycles. And the reason I call it degenerate is because there's in fact no rhyme or reason, there's no organization, there's no structure to it. It's very much *ad hoc*, sort of looking around what local materials are available and attempting to build in that direction. Here we see local plant managers using spare areas in their plant and excess labor, not shutting down production lines. Indeed, even lines that were closed because of lack of orders were maintained in a mothballed status, with the hope the somehow order would come back to the Soviet Union (and

indeed the coup of August represented that kind of hope among these people, to return to the good old days producing lots of interesting defense goods). So in fact defense lines were mothballed, and these guys hoped to wait out the turmoil and see a return to the original plan.

At the same time, wages and benefits in the defense sector were declining and declining very fast (because of the decline in defense orders and the fact that civil goods did not make up the difference), and so one saw a brain drain essentially from the defense establishment. It lost roughly half a million people over the last two years with the best skills and engineering talents. Simultaneously you begin to see the—well, the beginning of the chaotic collapse of the defense industrial supply structure, which I think is more important today than it was, is more important today for the issues of conversion than it was in the past.

And what basically happens at this point, in 1990, is that the VPK plan is resurrected. Gorbachev and the Supreme Soviet become convinced that in fact their sort of social conversion, what I called Systemic Diversification II, is not working, that it was crazy to have high technology R&D laboratories producing children's toys. And so they returned to the notion of trying to go back to a dual use technology base. They began marketing very heavily defense sector facilities to form joint ventures with Western companies for capital and technology and management skills. And you see a lot of activity beginning in 1990 over that. In fact, at MIT we actually hosted a conference which brought 40 of these guys here so they could meet Americans, and they spent most of the time trying to sell things, things they didn't have incidentally, but things they wanted to sell nonetheless. And this VPK plan in fact looked like it was going to be approved this past summer until the coup of August, at which point the VPK simply disappeared from sight. And so in fact there is no military industrial commission functioning anymore in the way that it used to.

That brings me to 1991, which is when I would argue degenerate conversion begins. This is the collapse of the military industrial command system, where essentially every defense plant manager is now on their own, operating by themselves, deciding what they're going to do, with which government (republican, municipal, or union), they're going to sort of take their cues from—but in most cases in fact what you have are all these plants now out there on their own. In some cases, defense production lines have in fact been removed and put into storage, hopefully to return one day, I guess.

But what you really have is a combination of entrepreneurship and panic. And these guys are now looking around desperately to try to find something to do, because they exist in an environment with no market cues, with no supply structure of any kind anymore, and with no sense of what a customer base might be. Now let me tell you one of the ironic outcomes of all this is in a number -- and it's a very large number of defense plants, they're actually producing more defense goods than are being ordered by the Ministry of Defense. Now from an economic standpoint that may be interesting but from a national security standpoint it's even stranger because here we are trying to verify conventional arms and strategic arms agreements some of which include caps on production of things and we're being given information by the Soviet military that certain things aren't going to be produced anymore and yet we're watching them come out of these factories. And the military's saying, "Hey, we didn't order them; these guys just won't stop doing it." And in fact [laughter] -- in fact, what's happened is, many defense plant managers have the labor, they have stockpiles -- someone said they were at a plant that had stockpiles of 50 years of tires; some of these places have ten and twelve years of parts to put into the goods -- and they're cranking them out. "Sasha, what are we gonna do?" "Well, make another tank, make another tank." "OK". [Laughter.] And these tanks are coming out. So in fact, in the area of Soviet tank production, it's substantially higher than what the Ministry of Defense has ordered. Fortunately, the

Ministry of Defense never paid for this stuff so it doesn't really matter. The bottom line is that right now the defense industrial base is on autopilot -- distributed, chaotic autopilot -- and no one knows quite what to do.

The future. Well, what about the possibility of republican-based, systemic conversion? In fact, Russia and the Ukraine have conversion notions; I wouldn't give them the word plan because they're clearly not plans. But they are notions, and basically their notions are they'll pay the wages of defense workers while the plants completely shut down and convert, which will take several years. And I find it very interesting that they're going to lay off 25 percent of their industrial work force for two years and pay them while they try to convert plants to products that they have no idea what they're going to convert them to. And so the problem you face is that, in all the republics, there's no inventory of defense facilities, none of these republic governments know what they have. In fact, even the VPK had trouble laying out everything that it owned, because it was built in such a strange way over the 40 years in which it was developed.

There's a very bizarre pattern of supply such that local suppliers don't exist for anything. Final assembly plants for missiles, for example, take place in Ukraine, parts come from every republic in the Soviet Union, and there are no duplicate plants. And as one of these plants winks offline because the local manager decides he's going to shift from making turbopumps to washing machines, all of a sudden that complete supply of a part dies out. But fortunately the final assembly plant keeps on going building the missile even though it's missing the parts that supply the fuel to the engine. [Laughter.] No problem, because the Ministry of Defense didn't order the missile anyway, so it really doesn't matter whether it works. [Laughter.]

There are severe problems with labor in that, of course, the plant managers don't want to lay off their labor force right now and so the shift, again at a local level, is to low technology goods. And I would argue that, ultimately, in most of the defense plants we're talking about with a few exceptions -- with a few exceptions but I think they are exceptions -- what will eventually be converted will be four walls, a floor and a ceiling, and everything else will not be useful because these are very specialized facilities that are not capable of doing much outside of their own specialized defense work. Now, if it turns out the Russians and Ukrainians really get hostile towards one another there will be a lot of work for these guys, but it won't be conversion; it'll be producing new defense goods. Their only problem is that, with the exception of Russia, no one else has all the infrastructure you need to build all the parts for all the weapons.

So, I think, the most likely and best outcome probably (this is my optimistic case), is in fact degenerate conversion coupled with entrepreneurship on the part of individual defense facility managers.

And what we see here would be a casting off of the baggage of the old central system and these individual facilities getting their act together, linking up with the West, with Western entrepreneurs, and trying to make it on their own. I cannot imagine in my wildest imagination how the republican governments can implement -- can formulate, let alone implement -- republican-wide conversion plans because they have no idea what's going on, nor how these places operate nor what to do. So for me, the implications are that conversion successes will be isolated pockets of enterprise; specific facilities in specific places that can be identified have a future. For example, some of the facilities doing work in optics would be a good example. But most of these defense plants don't do that. They turn out fairly routine military hardware which is ill-suited for anything other than what it was producing originally.

I think that republic government roles will probably end up being really one of social welfare for displaced workers, loan guarantees to new industries, most of which will fail, but in fact they won't be able to play a systemic role in conversion because the nature of the problem just dwarfs their administrative skills (which are open to question to say the least).

And then lastly conversion cannot -- military conversion cannot and will not -- be an engine for either the union or the republic economic change; I don't believe it. It'll be a product of it, certainly, and over the long term, may help in fact move it along, but it cannot be an engine. So those who are betting that military conversion is this sort of secret pot of money, a secret pot of technology, and a secret pot of expertise, are going to be very disappointed because in fact much of the success of the defense industry -- I would say 85 percent of the success of the Soviet defense industry -- was because it was parasitic. And only because it was parasitic, and without that parasitic relationship (which it has lost in the wake of the coup but actually it was happening before then), it did not function any better, in fact in some cases a lot worse, than the overall Soviet economy. We stop there.

*Jonathan Brown*

Thank you very much, Professor Meyer. Well. Secret pots of potential, entrepreneurs, capitalism brings us to Dean LeBaron.

*Dean LeBaron*

Not so secret. In fact my remarks may be perceived as slightly promotional, and I apologize to you and to the Securities Exchange Commission if that's true. But I think it's probably important that I give you the particular scenario that I have, and I share some of the same observations as Steve but reach entirely opposite conclusions. And I think that's probably interesting and you may well consider this the comic relief of the afternoon, if not the optimistic aspect.

I want to start now that I've said that this is promotional -- with a four-minute video, and this video was made to introduce the idea of investment in the Soviet Union, specifically in military conversion projects, to investors who are very serious, have real money, and are accustomed to being very tough and can invest anywhere around the world. So it's part what is true there but was also done in part with what was my idea of what they would be interested in. I might add that there have been 25 or so investors who have visited the Soviet Union with me, visited a number of enterprises and as near as I can tell, with no exception, that they will invest subject to some degree of structural concerns, you know, is the agreement on blue paper instead of white paper or, you know, is that a five-year fund or a ten-year fund, or things of this nature. But it has undergone the onsite examination. Now, what is onsite has been somewhat selective. But if I can give you a little video, sort of a relief of this. I think it summarizes many of the points, and I thank the staff of Larry's to have this here. As I say, this is promotional.

(VIDEO). OK. As I said, it's not promotional. [Laughter.] It's preceded by law with a little thing that says, "The following is not a solicitation to sell." Or whatever. But I think you see the point.

*Questioner*

Was this produced BEFORE the Iraq war ... [Laughter.]

*Dean LeBaron*

Produced six months ago. After. But, you saw the M72 which had been made of one of the tank  
[. . .]

My notion of the history of military conversion is that it started in an involuntary sense in 1982. In most of the defense companies I visited, they all have a museum, and there is a reverence for history in this country, and you are shown the museum. I've noticed that the museums of the defense companies all stop in 1982. History ended then, approximately with the death of Brezhnev. And that's when things started to get tight for military enterprises.

The next shock that comes in the process of conversion is 1985, the meeting between Gorbachev and Reagan in Iceland, where Gorbachev apparently put on the table to Reagan, and Reagan accepted, in the presence of their translators, a proposal that all nuclear weapons be eliminated and forget all the treaties. And Reagan went back and talked to George Schulz, and Schulz says, "You've got to check that with the California aerospace companies [laughter], and it's got to be properly staff; you can't make that deal; you can't deliver." At that time, Gorbachev could deliver. The same agreement has come back, and now in all probability Gorbachev can't deliver.

But that scared the VPK and others of the military policy in the Soviet Union, incidentally, has always been that the economy did what was necessary for the military to preserve defense, and anything that was left over went to the consumer side. And that was approximately, 20, 25 percent of GNP, but it didn't make any difference. The number one priority was to be globally competitive on the military side, and anything else went for shampoo and soap. But it was clear to the military at this point, in the mid-1985s, that that policy was no longer going to be true and that they'd better get going.

Military conversion started as a program in the late '80s, and admittedly, it's been more of a goal than a reality, in part because of the lack of market research. But in a sense, that's been very good, because since 1988, you can see strong evidence that the Soviet military has been trying to engage in constructive business association with the West to find out about what to do.

In the hundred or so companies that we've visited (I've probably visited personally maybe a third to a half of them), in almost all of those, about a year ago, at least there would be a table of products. We can build the following things. Please tell us what to build. And it's very scary because I have a feeling that if any Westerners said, "Build this," they would.

They are eager to have a market system and they expect the West to tell them what to do. And the attempts made at the Paris Air Show by the Soviet military and others, as you can see, to attempt to engage with the West have been very serious on their part but essentially have been rebuffed by the West because the West today has not engaged with them. And they don't understand it; they've been standing naked in the snow, saying, you know, we would like to do something with you, and nothing has been done, except more studies have been going on.

They are politically disintegrating, of course, that's been well enumerated here. But as far as the economics and specifically the business part of the economics, I find there is extraordinary unanimity there in terms of engagement to the West. I was in the Soviet Union during the week of the coup, with a group of investors, of all things. And on Monday night, which was the night of extreme tension

between the union and the Russian republic, I was at a dinner table, same place where you saw that champagne toast being made, with representatives, senior representatives of the Russian republic who were given passage out of the White House to come to have dinner with us, as well as members of the union government on the military side, both of whom had previously had guns pointing at each other, put them down to come out and discuss common policies of engagement with the West. And they then went back into the White House, picked up the guns again for the standoff, you know, on opposite sides of the barricade.

My associates (as squarely they say) have been both the reformers and the hardliners but in terms of business engagement with the West I have detected no difference whatsoever, and I think that's a point that is frequently missed. The common ingredient, the common unifying ingredient is that our associates in the Soviet Union, and I'm calling it that because I haven't got a better term, is that all sides believe that engagement with the West is a necessity, there is no other alternative regardless of how we actually get there.

So I'm not probably as disturbed by the politics as most people because if I had been disturbed by politics, I wouldn't have invested five years ago in Latin America, I probably wouldn't be invested now in India, and I wouldn't also be investing in China as well this year, as we are also in the Soviet Union.

The down side on this is that we can't let it happen. In other words, we can't allow the Soviet Union to not succeed. It is impossible. There are 30,000 nuclear weapons there. They have a market price. One of the things we could do which has been proposed is we buy their nuclear weapons one by one. Not a bad idea.

*Questioner*

Do you know the prices they'd be demanding for the nuclear weapons.

*Dean LeBaron*

I beg your pardon? The first one would be fairly cheap. The last one, the thirty-thousandth of them would be fairly expensive. [Laughter.] And as one Soviet said to me several months ago, "Be careful, it's not very good to be in the same woods with a wounded bear." And this bear is very wounded. And we have take care of our own self-interest. There are a lot of very dangerous toys there, not just only nuclear weapons.

The second of course is migration. The United States, my country, is engaging with Mexico not because it really likes to engage in Mexico, but because the Rio Grande isn't deep enough or long enough to prevent the migration. Nor can the Iron Curtain go back up again. Two hundred million people will move and as Steve said, they probably started -- almost every Soviet, I know, in the back of their mind has an alternative plan of what to do if it doesn't work. Which includes not staying there. And they will deny that, but that's not true. I mean, there is a mass impending migration. My interpretation of why some of the production keeps going is, as Steve mentioned, is not because they really want to produce tanks; they don't, but because they're attempting to keep the capital base of qualified workers going, and they don't know what else to do. And it's better than letting people sit around. I've been in lots of offices where, as I walk through, everybody's working very hard. And as I go through, and I've cheated a little bit, and turned around and gone back, and no one's doing a thing. [Laughter.]

I've also visited the same enterprise maybe ten times or so and I've noticed that coffee break seems to occur at any time of day because there aren't any people around. The Khrushchev rocket factory that you saw there, I've seen that often with nobody there. Last time I was there, there was a full complement of people. But they're to keep the capital base, which is highly qualified labor force. And if that happens to be making rockets or tanks, that's fine.

The other thing -- of course they could keep it going by getting rid of tanks. They don't don't know how to get rid of tanks. They know how to build a good tank, it's tough to get rid of. Build a bad tank, it's a little easier to get rid of. That's always a problem.

On the plus side for investment is the notion that this really is a superpower in many respects. So you have some very strong things to work on. In the command system, the Soviet gave people, Soviet command structure gave capital in support of the weakest enterprises. And the one thing you wanted to make sure is that you never ran out of tires. The fifty years of tires that were stockpiled -- I thought it was about twelve -- at the Kirov works that Steve mentioned, and they are there, is because they ran out of tires, you know, about 18 months ago, and they said they'll never run out of tires again.

I was there six weeks ago, and they ran out of batteries. And I'm sure that there is an order for batteries that some manager has put out to make sure that he has five years of batteries and he will never run out of batteries. The fact that a battery wears out at the end of two years is probably something that hasn't quite occurred to them. But they'll have five years of batteries because there's no capital cost. And money has gone to the weakest enterprise. Most Westerners who visit enterprises, and an American Deputy Secretary of Defense, Don Atwood, is there, today, probably visiting the weakest enterprises because the Soviet people want to sort of nurture the weakest enterprise. The capitalist system, in terms of rates of return, nurture the strongest enterprise, exactly the reverse. In other words, the ones that seemingly don't need it. But we can nurture the strongest. And indeed that's what private capital tends to do, to look for the Leningrad Optical or whatever the case may be and to nurture the strongest to get that sort of thing going.

But you find these here because indeed it is a superpower whereas in many developing countries there is nothing to nurture that can get the engine going; you've just got to bring the whole thing up. Very strongly.

This is a developing country that can make it on its own if it just kick-starts the right things. Obviously, you know, oil, agriculture, as well as probably the best item for the Soviet Union is ideas, the quality of the research people in the research institutes, or licensing the technology ideas that are actually here.

The enterprises are the ones that are coming up, as Steve said, strong and independent because their ties to the command structure have ceased and after January 1 are essentially all gone. So there is a sort of growing up, almost underground economy, it's happened 20 years ago in Italy, it's happening - it's happened in the last decade in Latin America, and it's happening here. The enterprises are determining their own destiny, and they just sort of taking on their investment themselves. They all have -- and are employing various techniques to engage in the West.

Let me just mention briefly how we go about picking enterprises. We have selected six out of the hundred or so that we have seen, that's a success ratio of six percent. We looked for technology first, quite clearly at or better than so-called world class. The final selection is often made on management.

The greatest surprise to me having visited enterprise around the world that the management skills in the Soviet Union were probably the best I have seen in the world. If you can run a Soviet enterprises, you are extremely resourceful. [Laughter.] You walk in in the morning, and there are going to be fifty evils that befall you, and you haven't the faintest idea what they are, but you have to survive, and do it over and over again. And it's even worse than operating in the stock market.

I was reminded -- this is an aside -- sort of that -- the old story of George Bernard Shaw receiving a letter from Jenny Lind, the music hall actress. George Bernard Shaw was in his seventies and Jenny Lind was in her twenties or thirties -- and Jenny Lind wrote, "Dear Mr. Shaw, I would like to have a baby with you. The baby would have your brain and my body." And George Bernard Shaw wrote back, "Dear Miss Lind, That's not a very good idea because there is at least an equal chance that it would have your brain and my body." Similarly in the Soviet Union, they have a terrible system but extraordinarily good people. I'm not convinced based upon the performance of market share on a global basis that American companies have as good people as they used to have, but we have a very good system. And if we can find a way to make sure we get our system and their people it'll probably be pretty good.

Sponsorship is very important in the Soviet Union. When you decide on investment there you can't do it on an analytical basis but you do it the way you used to do it probably a hundred years ago in the American wild west, you also do it in Latin America and some parts of Asia. You do it on sponsorship and face. Character. And those are the analytical tools which work. But it's a different set than most of us have who've come from a business school type background.

Initiative. We look for a global outlook. Leningrad Optical, curiously enough, has a map of the world in its showcase, and it's had that map there for about 15 years, despite the fact that it never sold products up until five years ago, outside their world. But it was a sort of mentality that they were globally competitive, and they read the magazines.

We look to see whether or not they can benefit from partnership with a global partner. I would not invest in a Soviet enterprise that I have seen unless it had a global partner because the gap is that they need no-how, marketing, whatnot, they need a buddy, a strategic alliance. But with that, and with money, a number of them, I think, can survive. Maybe not thousands, but six. And it might be -- there might be -- you might be able to double that. But you do that in the first instance in that I think that can occur, you know, with the system that really causes this whole thing to come down.

What can you do about it? First thing is we can give some advice to the Western governments. We've given a lot of advice here today to the Soviet Union and the republics and the cities and so forth but let's give some advice in effect to ourselves first.

The Western systems are on the back of the Soviet economy in some very, very important ways that it would be easy and cost-free to remove. Number one is communications. We all know that communications is terrible. The principle barrier to communications is that there are restrictions to communicate using Soviet communications satellites if you happen to be a Western communications carrier. This is a normal hamper to free market -- incidentally the most zealous, of course, for free markets, are in the Soviet Union. That may well change, but you know, aren't Americans in favor of free markets? Well, probably we're not. But if they -- if we can use the Soviet communications satellites, the communications problem, which is a hampering activity to doing business both within the Soviet Union and outside, would disappear right away. But we can't do that because we have to support the American satellite that can't seem to get a satellite up.

The second is visas. It takes typically as we all know, anywhere from four to six weeks for a Soviet to get a visa here, and if it actually coordinates with getting an airplane ticket, so much the better. So if you're doing business with a Soviet partner and you get something over here that breaks and the guy who knows how to fix it is there, you're going to have to wait four to six weeks for him to come here, that's pretty silly. I have had Americans complain -- American government officials complain that we bring too many Soviets over here; did I not understand that Americans have a limited budget to keep track of the Soviets who are rattling around the United States, and could I slow down so that we could keep track of where they're going? This is counterproductive when, at the issue of general policy, we're attempting to try to help the exchange and not hinder them. I have not slowed down.

And finally is COCOM. COCOM really has worked. As a cold war device it hampered the Soviet economy and there are a variety of things where you can see that could be fixed very quickly on an economic basis assuming the parts and the technology could be brought in from the West, the way we do it. If you happen to be an American semiconductor manufacturer you'd have testing equipment from Japan, photo equipment from Germany, you know, and packaging from heaven only knows where -- probably Brazil. COCOM -- I just saw the very -- just two days ago the best report I've seen on what should happen to COCOM; it should increase the number of its staff and devote itself to worrying about security problems with small nations. And this one may well go because it had the provision to increase the COCOM staff, rather than all the other proposals which had been to eliminate it. [Laughter.] So I'm more optimistic about COCOM now than I have been up until two days -- it is an anachronism that should not exist.

Second is to concentrate. The Soviets tend to think everything of course in large, macro issues, Bolshoi this, Bolshoi that and so on. And do little things. And we should probably follow the principle of doing little things. One is on the geographic sense. Probably if you had to pick a geographic area that is more promising to invest in than anything else one might pick St. Petersburg, for a whole variety of reasons. And that doesn't mean that there aren't other places but sort of pick an area in effect as a model. The Chinese have done this with their free economic zones along the coastline and those essentially are models around which you want to try everything.

There obviously is tremendous problem with food aid. American keep sending food study missions over there to study the problem. I've had a number of Soviets complain, "But we have to feed these food missions; it's making the problem worse." [Laughter.] And you're not going to get food aid over there unless it's in the wintertime, and it is going to be a problem. But we'll send over more missions to help them on the distribution problem, and that means more dinners and more lunches and more time. And that's beginning -- there's going to be worse of a problem in the future unless we all carry our own little doggie bags with us when we go on the food aid.

The military is still viable. It's not sure, you know, the state commission that Steven mentioned is very interesting. It used to report to the cabinet of ministers, which doesn't exist anymore. People still go to work, not as many people as went to work there a couple months ago, but they do. They still issue pieces of paper and pieces of paper come back. But essentially it's an anachronism. And it really doesn't accomplish very much, and people there know it. But it doesn't make any difference. In spite of the fact that these are my colleagues -- How loss of prominence doesn't make any difference because the enterprises are the ones that are strong. And that's why a year ago we called this a Soviet companies Fund, you know, not the Soviet ministries fund, or the like. The ministries are acting more and more in the role of management consultants.

Third, the advice to ourselves is to be visible. Someone mentioned this morning how important it was to instill hope. There really is very, very little hope on the part of the people there. I arranged for one presentation by a diesel engine manufacturer with a diesel engine manufacturer here and after a long, technical discussion about the engines and how important they were and how good and what a great market it is, and it's the best market in the world incidentally for diesel engines in the Soviet Union because they've all built these big tractors, and if you break up, you're not going to -- they don't have any small tractors so it really is the best market for diesel engines anywhere in the world. And finally the question came from one of the executives of the American diesel company, "Really, why should we do business with you?" And the senior executive broke down and cried and said, "If you don't, my children will starve." Not normally what I would suggest as a presentation close [laughter], but it's true. And that is a very high motivation on both sides to do things. You know, sort of really have the attention. So, you know, I think what one has to do is be visible because it does instill hope.

There is a model, and the model is Poland. There's the Polish enterprise fund, which is essentially U.S. government money, which is support -- which comes out looking like a venture capital fund. And if I'm right that the enterprises are the strong ones, that in terms of enterprises, what you're trying to sort of instill, maybe the Polish enterprise fund is the kind of model to actually follow.

And in terms of when to do it, you know, it seems to me, I mean I must admit I'm attracted to the Soviet notion and so forth that is that time is wasting. To accomplish our objectives, it's just getting more and more expensive, that time is terribly destructive. Thank you.

#### SESSION FIVE: THE ROLE OF THE WEST

*W. A. Wapenhans.* [Extended presentation on the World Bank technical assistance program.]

*Jeffrey Sachs*

Thank you very much. My main message is very simple, which is that the clock has started ticking on the time bomb of Russian reform. I think that the time for endless philosophical discussions about union versus federation versus confederation is now past, even though it went very fast I admit. The important thing right now is to help the Russian stabilization and liberalization effort, which is going to begin within sixty days and which is going to be one of the great and tumultuous events of world history.

It will be a very sad and difficult and perhaps even dangerous process. I don't think the West is geared up to help Russia yet and I worry about that. I find it disturbing and revealing that, as far as I know, neither Mr. Preston nor Mr. Camdessus, nor Mr. Bush nor John Major nor any other Western leader, has stood up in the last two days to take cognizance of what was the most important significant pronouncement on Russian economic change in recent history on Monday. I find that very worrying because I believe that the Western political leadership is not awake and not aware, and that we are walking into a very, very dangerous situation right now.

I believe that the situation is tragic in the sense that the outcome could well be quite horrible and yet there is no alternative right now to doing things which could have that horrible outcome. I don't believe that Russia has an option of going "gradually" for example to ease the shock of reform. Russia is on the edge of hyperinflation. It may even be in one in the technical sense (inflation of more than 50

percent per month). This crisis defies gradual treatment because there is a burgeoning collapse of much of the tax system, and a collapse of much of the economy.

Russia's financial conditions are about as bad as anything that has been observed in the modern world. So when Yeltsin announced on Monday that he was going to free the prices, float the ruble, and slash subsidies, I think that was a realistic course, even though the consequences could be disastrous politically. In fact, the Russian people are ill-prepared, compared with the Eastern Europeans, for the radical reforms that are about to come. Compared with Eastern Europe, Russia lacks the knowledge of a market economy, and of course has had a far longer and more brutal period of communist rule.

With our without radical reforms, Russia is about to be shaken by explosive change. We just heard the last hour that the core of the Soviet industry, which is the military-industrial complex, has for all intents and purposes collapsed and that collapse has sent reverberations from the Elbe to the Volga. Heavy industry throughout the entire socialist world is in deep crisis, and that is irrespective of whether a particular country is reforming or not. This collapse means that you are going to be dealing with millions of dislocated people—no matter what policies are followed in Russia. You also have the fact that normal administration can't function, and that the state enterprises are bereft of clear objectives right now because there are no commands that come from on high, and there are no real owners. When commands are issued now, there are no reasons to obey them, since (mercifully) the old system of communist terror has disappeared.

Now, the fundamental economic "disease" that I have described is similar to that in Eastern Europe, though far more acute. The basic approach to reform that has been adopted in Eastern Europe is therefore also appropriate to the Russian situation, though the chances for success are less given the greater social and political obstacles. The first step of reform should be to create a working monetary system, and to allow markets to function. Emergency efforts should be made to balance the budget at the same time. Following these measures of liberalization and stabilization, the goal should be to create private ownership as rapidly as possible. What is clear is that even in Eastern Europe, where the population is much more prepared for this set of policies, the anxieties that are created from the total dislocation of the old communist society are very, very high. But remember, with the collapse of the old system, huge dislocations are inevitable.

Since the social dislocations and confusions are bound to be great, the political challenge of economic management is extraordinary. These profound political difficulties are being seen in Poland, Czechoslovakia, and elsewhere in the region. I think that the problem of political management is going to be far worse in Russia.

For these reasons, I don't think the West has the luxury to sit and wonder about who is going to sign the union agreement or what is exactly going to be the economic agreement, and so forth. It has been staring everybody clearly in the face for at least the last two and a half months that there isn't a Soviet Union any more, though the White House has been reluctant to admit it. And now Yeltsin has said that Russia is going ahead with reforms, and yet President Bush is still not moved to support these reforms, and the international financial institutions are still semi-paralyzed, I would say.

Assuming that the IMF and World Bank are finally mobilized into action, there is of course a great deal that is known about how to give international support to Russia. We've gone through twenty or thirty major stabilization programs around the world in the past ten years. There is a style to them, indeed a whole choreography. There is a way of giving aid to countries in the process of comprehensive

reform, for example that is now at work in Eastern Europe, and I think that our best hope is to do the same thing for Russia. We should design a multi-faceted assistance program for Russia like we did for Poland or like was done for Czechoslovakia or was done for Mexico, and there is a great deal that is known about how to do it.

What does it mean operationally? First, I think you have to get ready to have an IMF program negotiated by the end of this year. Since Russia is not a full member of the IMF we ought to think, in formal terms, about an "IMF-supervised program" negotiated between the Russian government and the International Monetary Fund (and actually approved by the IMF Executive Board, as with a normal program). That would mean a letter of intent, numerical targets, and all the rest. Balance of payments support ought to come along with that. Since the IMF would be unable to lend the money directly, the G-7 (or G-24) should be called upon to *ante up* the funds that would otherwise be provided by the IMF. But the G-7 funds would be predicated and conditioned formally on the IMF program.

In essence, the program would be managed as if Russia were a full member of the IMF. Given that there is a whole structure of what to do, that shouldn't be so mind boggling to arrange. There are budget preparations to analyze, there are balance of payments assessments to be made, and there are structural issues to be discussed and negotiated with the Russian Government. Once a formal IMF program is negotiated, there ought to be significant financial assistance to back it up.

My own guess is that given the enormity of the situation and the stakes of the world in this, we ought to be trying to mobilize during 1992 something on the order of 15 to 20 billion dollars for Russia, and that would be in the form of emergency food assistance, financial balance of payments support, stabilization fund, and technical assistance fund, and roughly something like 5 billion food, 5 billion balance of payments, 5 billion stabilization fund and 1 billion of technical assistance work.

Much of the balance of payments support, other than the stabilization fund, should be delivered under the aegis of the World Bank. As with an "IMF-supervised program," there ought to be a "World Bank-supervised SAL." Again, the idea would be to negotiate with Russia as if Russia were already a full member of the international financial institutions. The World Bank would enter into the same set of negotiations as in a normal SAL, and it would try to deliver several billion dollars in the course of 1992, having the money conditioned as in a SAL.

I would suggest tying the money to two SAL programs: the creation of a social safety net, and the marketization of the agricultural sector. I would think that the World Bank's major attention should be on these two issues right now, rather than on the focus on individual industrial or mining sectors. The focus on the social safety net is especially urgent—the Russian Government must work urgently to hold the society together during the first and most tumultuous phase of the reforms.

If the West comes in generously with social support, I think it can do a great deal to help make a psychological break with the past, and to help welcome Russia into the world community. As I understand Russian history, Russia is a country that has only been invaded, that it has never been shown generosity throughout its entire history. Therefore, the idea of giving Russia money may be an enormously favorable surprise for Russian people. Also, tying Western Aid to the financing of a social safety net would seem to be both politically wise and psychologically important.

Finally the last part of the package should be debt forbearance. There is no question that the debt servicing has to stop for the short term, if only to find out what the real situation is. The notion that the

most important thing for the Soviet Union right now is to pay its debt service is an evil myth that only Horst Shulman could think of. But for anyone to adopt this as policy is absolutely cockeyed thinking. Russia can service its debts in the long run, but not at the moment of intense financial catastrophe and the introduction of radical reforms.

With regard to the agricultural sector, the real issue is liberalizing food prices and food marketing, rather than technical assistance in food distribution and improving the factories and the bakeries and so forth. The Russians know how to bake bread and how to ship wheat. The problem is a lack of incentives, not a lack of know-how. The most important steps, therefore, are to liberalize food prices, free up the marketing of food, and privatize the trucks in the society (e.g., by selling the army trucks), in order to reestablish markets, both wholesale and retail. Already, there are hundreds of commodity exchanges in which food may be traded on a wholesale basis. These wholesale markets should be supported as well. And perhaps there should be a program on emergency food assistance (cash grants or food stamps) as a safety valve for what will be a very shocking period.

In essence, I doubt that there is anything deeply wrong with food distribution in the Soviet Union that markets won't solve. Despite this, you see films each week on CNN about the problems of the bakeries and trucks and so forth. But the real problem is more simple—it is called incentives. It would be wrong-headed for the World Bank to get involved in the mechanics of baking or trucking or harvesting at this point—instead of setting forth the conditionality to require free prices, and private distribution networks.

Finally, a point that I mentioned earlier today. I think we would be very wise to think about a partial mass privatization of industry on the first day of the program by a legal conversion of all enterprises into joint stock companies (all enterprises over a certain number of employees), and an immediate transfer of ownership of 20 percent to 30 percent of the shares to the workers within the enterprises with some very general guidelines of how to do it. The key is to get the economy irrevocably (partially) privatized, to help create a base of social support for this transformation among the industrial workers, and to give some sense within the enterprises of what the stakes of the workforce in their survival. That was not done in Poland, and I think it has been a very deep political error and a very deep economic error that lingers to this day.

Privatization is generally handled by technocrats who are fascinated by stock markets. The whole process has been widely misunderstood among the technicians, and consequently has been wrongly dealt with from a political point of view in Eastern Europe. It's been a very costly mistake. There may even be a way to use the across-the-board privatization as a way to control the money supply. Each enterprise could be required to use part of its accumulated cash balances to "buy" the shares on behalf of the workers, thereby sharply diminishing the enterprise funds in circulation.

The next step after two months would be to go the Ukraine, because they are going to do the same thing, and practically speaking the idea of handling fifteen republics right now is not a good idea. But starting with Russia first and Ukraine next is a good idea, and I would "assign" Sweden and the other Scandinavian countries to take care of the Baltics.

Finally, on the issue of economic agreement among the republics. I don't think it is wrong for the West to push for agreements on certain things. I think that we ought to insist that the external debt should be repaid in the long term, and that the republics should sort out their responsibilities for paying it (though it is absolutely foolhardy to suggest that it should be serviced in the short run). We ought to

press the republics to maintain open trade amongst themselves as well. But that is where I would stop. We are not within our rights to insist on any greater degree of political integration, of the sort that Yavlinsky was trying to negotiate in the "economic agreement." That is not going anywhere, and was not fruitful.

To maintain free trade simply requires individual currencies that float amongst each other, rather than a unified monetary system. There is no case for insisting on a single currency, as John Williamson and Oli Havrylyshyn have correctly stressed. At the same time, however, I see little case, at least in the next few months, for a payments union either. Floating exchange rates can do the job of maintaining trade among the republics. We ought to push for what is "pushable" and for what is absolutely necessary for trade among the republics, and stop pushing for a more maximalist agenda of political unification.

*W. Wapenhans*

Thanks very much, Jeff. That will give us more than we can discuss this afternoon. But perhaps, John, you have some of the answers to that already.

*John Hardt*

I plan to make some additional observations. At present we should focus on the Russian program of Boris Yeltsin. There are two scenarios: One is that the program will proceed and be relatively successful; the second is that Yeltsin's program will collapse. There is no middle ground. Yeltsin's government is unlikely to rise from the ashes of collapse. We should consider the costs and benefits of both options including the downside, that is, the costs of collapse in governments. I think that a full commitment to assistance even a "fast-track" approach, including a "shadow program," makes sense. But it makes sense for the institutions, the multilateral institutions such as this one, as well as the United States and the other G-7 members not because we want to give them something but because of our mutual interests. It is important not just for political, security, and human rights reasons but economically to frame our support in that context. On the upside are the substantial improvements in our security position, on regional issues, and reduced tensions around the world (e.g., Afghanistan, Cuba), and the market possibilities in terms of potential jobs, production and markets; on the down side, if there is a collapse in this area, instability will increase, regional tensions will revive and there will be very severe impact on central Europe and Eastern Europe and the world in general. The question of balancing the risks and opportunities takes on an urgency, time is of the essence. The interest rate is really very high for action and commitment: November is already late, January is later, next year is much too late. Therefore, one should give this sense of commitment now serious attention. Delay is costly.

Success is going to be based upon the popular acceptance of legitimacy and acceptability of those who have committed themselves to the program in Russia, and most particularly Yeltsin. Performance is essential to maintaining legitimacy. Performance would avoid a disaster during the winter in the major cities; performance would be to have some concrete results that demonstrate that there is a possibility of success, some credible basis of hope. One can delineate some of the negative things to avoid, such as the substantial unemployment, falling living standards and shortage crises in critical areas. But if we can not focus - or do not focus - on supporting areas of credible performance, it's going to be very hard for Yeltsin to come to that date that he set for himself in Fall 1992 and tell his electorate, "Judge me by my record." So it's important to keep performance in mind in food deliveries, medicine, energy, housing, and environment.

The need for better coordination and conditionality needs more attention. Money and training are not enough, it is how well they are used. The multiplicity of donors must orchestrate together. Stanley Fischer, former Chief Economist of the Bank, has suggested an Office of Soviet Aid Coordination for coordination of information. There might also be a high level policy of the coordination group of the G-7, that deals not only with economic conditionality and coordination but also political conditionality. Because each of the performance areas requires attention to the broader political, security, regional, and interregional issues, they need to be judged by the G-7 political leadership. And it should be done at a high level, because success is going to depend on how the comprehensive mutual interests are served. I am stressing again mutual interest not just because our Western publics are not going to buy any program that is a gift of tax funds unless it is clearly demonstrated it's in our interest. Moreover a broader G-7 policy group could help provide the vision for the profound transformation necessary and exercise the conditionality to keep the systems in transition on course.

Effectiveness also involves targeting; some targeting is appropriate for the World Bank. Institutionally, you should consider a time-sensitive agenda of the critical issues to target. Critical issues include the food and energy chains, conversion not only of military support but noncompetitive enterprises (e.g., the large enterprise privatization question), regional and transitional developments. In each of these areas there is a role that the World Bank could usefully play that is not appropriate for others. For example, in the food chain, infrastructure is quite important, and all of the elements of infrastructure are not well handled. Although Dwayne Andreas, CEO of Archer Daniel Midlands, at the Bretton Woods meeting, as many of you heard, seemed to suggest that the private sector could do most anything; it is really not quite that way. Nor can the reformers in the Yeltsin plan do everything either. But it is crucial to performance to do something about reducing the losses in the food chain, e.g., 50 percent loss of potatoes according to the European Bank for Reconstruction and Development (EBRD). I would suggest transportation, storage, other elements of infrastructure are appropriate foci for the Bank.

In listening to the oil companies on developing an energy policy in the multinationals all looked to the World Bank for what they provide in other countries (e.g., Indonesia) certainly not in field management but there is a definite and a critical role in expanding the institutions and infrastructure in the energy area.

When considering the energy sector, we should also note the important role of Western investment in the Russian program. The importance of direct investment in Soviet oil in the very near term is one of the crucial variables, and the prospect of Western investment commitment will be influenced by the involvement of the Bank, the Fund, and the G-7 countries. But the condition precedent is the Yeltsin commitment to a credible program.

In reference to the question of the conversion and noncompetitive enterprise, the Polish experience is relevant. There is a problem of unemployment and it is not entirely psychological. Closing the large steel mills, machinery plants producing either for civilian or military economy creates a politically important economic problem of unemployment. The Russians need macroeconomic and analytical capability to deal better with the tradeoffs of employment, growth, and price stability. This subject may be appropriate for this organization.

There is also a very time-urgent set of questions that have to do with the infrastructure and the quality of life, which are also regional issues: environment, health, energy are regional issues. The unified Germany is now getting advanced telecommunications, but the rest of the region is not to be unified with the West. The environmental, health, and energy issues are all interrelated to each other.

The regional energy issue is being addressed by the European Community. How is the Bank coordinating with the EC on this issue? These are time-urgent questions to be targeted for the precise World Bank programs. Perhaps I've missed the target but I am not shooting for the inside part of the bull's eye but deferring to you on what is most relevant. I understand your earlier discussions did deal with the question of targeting, but I wish you luck on getting the right part of the target.

Finally, let me commend you on the nature of the group assembled here by the World Bank. We are finally getting together Soviet specialists, international economic specialists, Soviet specialists from the Soviet Union and the international institutional expertise. Although Russian and Ukrainian citizens are not in the room an appropriate blend of expertise is here. May I commend the Bank for arranging this type of participation that has enriched our dialogue and opened the possibility that our insights will be correct.

*W. A. Wapenhans*

Thank you very much, John. We have had a very rich agenda presented by our two speakers.

## SEMINAR ON THE SOVIET UNION

Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economies Reform Unit, Country Economics Department  
Wednesday, 30 October 1991

### List of Participants

Anders Aslund  
Director and Professor  
Stockholm Institute of Soviet and East  
European Economics  
Stockholm

Mario I. Blejer  
Division Chief  
Macroeconomic & Growth Division  
Country Economics Department

Karen Brooks  
Economist  
Agricultural Policies Division  
Agriculture and Rural Development  
Department

Jonathan Brown  
Division Chief  
Infrastructure, Energy and Environment  
Division  
Country Department V  
Europe, Middle East & North Africa

Stuart Brown  
Assistant Professor, Economics  
Georgetown University  
Washington, DC

Nicholas Bruck  
Financial Economist  
Finance, Industry, and Energy Division  
Economic Development Institute

Richard T. Burcroff II  
Principal Economist  
Agricultural Policies Division  
Agriculture and Rural Development  
Department

David A. Craig  
Senior Economist  
Country Department V  
Europe, Middle East & North Africa  
(from December 1, 1991)

Csaba Csaki  
Visiting Fellow  
Agricultural Policies Division  
Agriculture and Rural Development  
Department

Wafik Grais  
Economic Advisor  
Office of the Regional Vice President  
Europe, Middle East & North Africa Regional  
Office

Paul A. Goble  
Special Advisor to the  
Assistant Secretary on Soviet Nationality  
Issues  
Department of State  
Washington DC

40 Seminar on the Soviet Union

Farid Dhanji  
Senior Country Economist, Romania  
Country Operations Division  
Department V  
Europe, Middle East & North Africa

Martha de Melo  
Lead Economist, Office of the Director  
Country Department V  
Europe, Middle East & North Africa

Dennis N. de Tray  
Senior Economic Adviser to the Vice President  
Development Economics

Francis Dobbs  
Film and Video Project Officer  
External Affairs Office

Bernard Drum  
Senior Industrial Economist  
Private Sector Development  
Country Department V  
Europe, Middle East & North Africa

Andrew John Ewing  
Principal Industrial Specialist  
Industry and Energy Division  
Europe, Middle East & North Africa Technical  
Department

Qimiao Fan  
Young Professional  
Technical Cooperation Unit for the Soviet  
Union  
Country Department V  
Europe, Middle East & North Africa Region

Shakil A. Faruqi  
Principal Financial Economist  
Finance, Industry and Energy Division  
Economic Development Institute

James K. Feather  
Director  
Publications Department

Delbert Fitchett  
Senior Economist  
Agriculture and Rural Development  
Division  
Economic Development Institute

Alan Gelb  
Division Chief  
Socialist Economies Reform Unit  
Country Economics Department

Cheryl Gray  
Senior Economist  
Socialist Economies Reform Unit  
Country Economics Department

John Hardt  
Associate Director and Senior Specialist in  
Soviet Economics  
Library of Congress  
Washington, D.C.

Parvez Hasan  
Chief Economist  
Office of the Regional Vice President  
Europe, Middle East & North Africa  
Regional Office

Manuel E. Hinds  
Division Chief  
Trade and Finance Division  
Europe, Middle East & North Africa Technical  
Department

Richard Hirschler  
Editor of *Transition*  
Socialist Economies Reform Unit  
Country Economics Department

John A. Holsen  
Special Advisor  
Senior Staff Resources Program  
Office of the Vice President Personnel and  
Administration

Mari Horne  
Consultant  
Technical Cooperation Unit for the Soviet  
Union  
Country Department V  
Europe Middle East & North Africa Region

Lars A. Jeurling  
Division Chief  
Technical Cooperation Unit for the Soviet  
Union  
Country Department V  
Europe, Middle East & North Africa Region

Sergei Kapitza  
President  
Physical Society of the USSR

Alexander Karpov  
Project Director  
American Soviet Economic Educational  
Television  
Boston, Massachusetts

Daniel Kaufmann  
Principal Economist  
Technical Cooperation Unit for the Soviet  
Union  
Country Department V  
Europe Middle East & North Africa Region

Harinder S. Kohli  
Director  
Europe, Middle East & North Africa  
Technical Department

Eugenio F. Lari  
Senior Advisor  
Office of the Regional Vice President  
Europe, Middle East & North Africa  
Regional Office

Fred D. Levy  
Senior Economic Advisor  
Economic Advisory Staff

Dean LeBaron  
Founder and Trustee  
Batterymarch Financial Management  
Boston, Massachusetts

Johannes F. Linn  
Vice President  
Financial Policy and Risk Management  
(from December 1, 1991)

David Lipton  
Vice President  
Jeffrey Sachs & Associates

Millard F. Long  
Senior Advisor Financial Systems  
Office of the Director  
Europe, Middle East & North Africa-  
Technical Department

Charles P. McPherson  
Senior Energy Economist  
ESMAP Operations Division  
Industry and Energy Department

Steve Meyer  
Professor of Defense and Arms Control  
Center for International Studies  
Massachusetts Institute of Technology  
Cambridge, Massachusetts

Costas Michalopoulos  
Senior Economic Advisor  
Office of the Director  
Policy and Review Department

John Nellis  
Lead Management Specialist  
Public Sector Management and Private  
Sector Development Division  
Country Economics Department

Domenico Mario Nuti  
Economic Advisor on Eastern Europe  
Commission of European Communities  
Brussels

42 Seminar on the Soviet Union

Arthur Obermayer  
President  
American Soviet Economic Educational  
Television  
Boston, Massachusetts

Marsha M. Olive  
General Operations  
Vice President and Secretary

William Onorato  
Senior Counsel, Energy & Mining  
Legal Department  
Europe, Middle East & North Africa-  
Technical Department

Guy Pierre Pfeffermann  
Director Economics Department  
and Economic Advisor of the Corporation  
International Finance Corporation

Peter Reddaway  
Professor, Pol. Science & Intl. Affairs  
Elliott School of International Affairs and  
Department of Political Science  
Georgetown University  
Washington, D.C.

Jeffrey Sachs  
Professor of Economics  
Department of Economics  
Harvard University  
Cambridge, Massachusetts

Bertrand M. Renaud  
Housing Finance Advisor  
Technical Infrastructure Division  
Europe, Middle East & North Africa  
Technical Department

Enrique Rueda-Sabater  
Senior Private Sector Development Specialist  
Public Sector Management & Private Sector  
Development Division  
Country Economics Department

John D. Shilling  
Manager  
Financial Advisory Service Unit  
Cofinancing and Financial Advisory Services

Martin Schrenk  
Consultant  
Socialist Economies Reform Unit  
Country Economics Department

Julian F. Schweitzer  
Division Chief  
Latin America Technical Human Resources  
Division  
Latin America Technical Department  
(from December 1, 1991)

Inderjit Singh  
Principal Economist  
Socialist Economies Reform Unit  
Country Economics Department

Lawrence H. Summers  
Vice President Development Economics  
and Chief Economist

David Tarr  
Senior Economist  
Trade Policy Division  
Country Economics Department

Jacques G. Toureille  
Senior Financial Specialist  
Private Sector Development Division  
Country Department V  
Europe, Middle East & North Africa

Boris Velic  
Program Manager for Asia and the Pacific  
Foreign Investment Advisory Services  
International Finance Corporation and  
Investment Guarantee Agency

Paulo Vieira Da Cunha  
Senior Economist  
Policy Development Division  
Policy and Review Department

Milan Vodopivec  
Consultant  
Socialist Economies Reform Unit  
Country Economics Department

Andrew Vorkink  
Chief Counsel  
Asia Division  
Legal Department

Harold E. Wackman  
Division Chief  
Industry and Energy Division  
Europe, Middle East & North Africa  
Technical Department

Christine I. Wallich  
Principal Economist  
Public Economics Division  
Country Economics Department

W. A. Wapenhans  
Regional Vice President  
Europe, Middle East & North Africa  
Regional Office

Roberta Waxman  
Consultant  
Office of the Director  
Country Department V  
Europe, Middle East & North Africa

Steve Webb  
Senior Economist  
Macroeconomic Adjustment & Growth  
Division  
Country Economics Department

Martin Weitzman  
Professor of Economics  
Department of Economics  
Harvard University  
Cambridge, Massachusetts

John Williamson  
Director  
Institute for International Economics  
Washington, D.C.

John Wilton  
Senior Economist  
Country Operations Division  
Country Department V  
Europe, Middle East & North Africa

Lars Winoy  
Professor  
Department of Political Sciences  
University of UMEA  
Sweden

Kathryn Wittneben  
Professor  
Elliott School of International Affairs  
George Washington University  
Washington, D.C.

Kevin Young  
Enterprise Reform Task Manager  
Private Sector Development Division  
Country Department V  
Europe, Middle East & North Africa

Ulrich Zachau  
Advisor  
Financial Advisory Services  
Cofinancing and Financial Advisory Services  
Department

Vladimir G. Kreacic  
Finance, Industry and Energy Division  
Economic Development Institute



## SEMINAR ON THE SOVIET UNION

Country Department V, EMENA Region  
Vice President, Development Economics and Chief Economist  
Socialist Economies Reform Unit, Country Economics Department  
Wednesday, 30 October 1991

### Selected Readings

1. Asilis, Carlos M., and Stuart, S. Brown. "Is a Marshall Plan for the Soviet Union Efficient?." Paper prepared while both authors were visiting fellows at the Stockholm Institute of Soviet and East European Economics, Stockholm School of Economics, Sweden, July 1991.
2. Fischer, Stanley. "Economic Reform in the USSR and the Role of Aid" (Preliminary: September 1991). Paper prepared for a Brookings Panel Symposium on the Soviet Union After Communism, September 13, 1991.
3. ----. "The West's Challenge: Coordinating Soviet Aid" *International Economic Insights*, Vol II, Number 5, September/October 1991, pp. 2-5.
4. Hardt, John P. "The USSR's Entry into the Global Economy." Moderator's Notes, Bretton Woods Committee, October 28, 1991.
5. Offer, Gur. "Fiscal Developments and Economic Reforms in the Soviet Union: 1991" (First draft). Paper presented at the 47th Congress of the International Institute of Public Finance, Leningrad, August 26-29, 1991.
6. Reddaway, Peter. "The End of the Empire." *The New York Review*, Volume XXXVIII, Number 18, November 7, 1991, pp. 53-59.
7. Summers, Lawrence, H. "How should the West help what was the USSR?" Paper prepared for the Wharton School, Pennsylvania, USA, October 22, 1991.
8. Walter, Norbet. "A Soviet Development Bank?" *International Economic Insights*, Vol II, Number 5, September/October 1991, pp. 6-10.
9. "Yeltsin's Bitter Pill." *Financial Times*, October 29, 1991.
10. "USSR: The New Community Treaty." Published by *Isvestiya* and Collected from *FBIS* by Martin Schrenk, October 5, 1991.