Breaking up is hard to do
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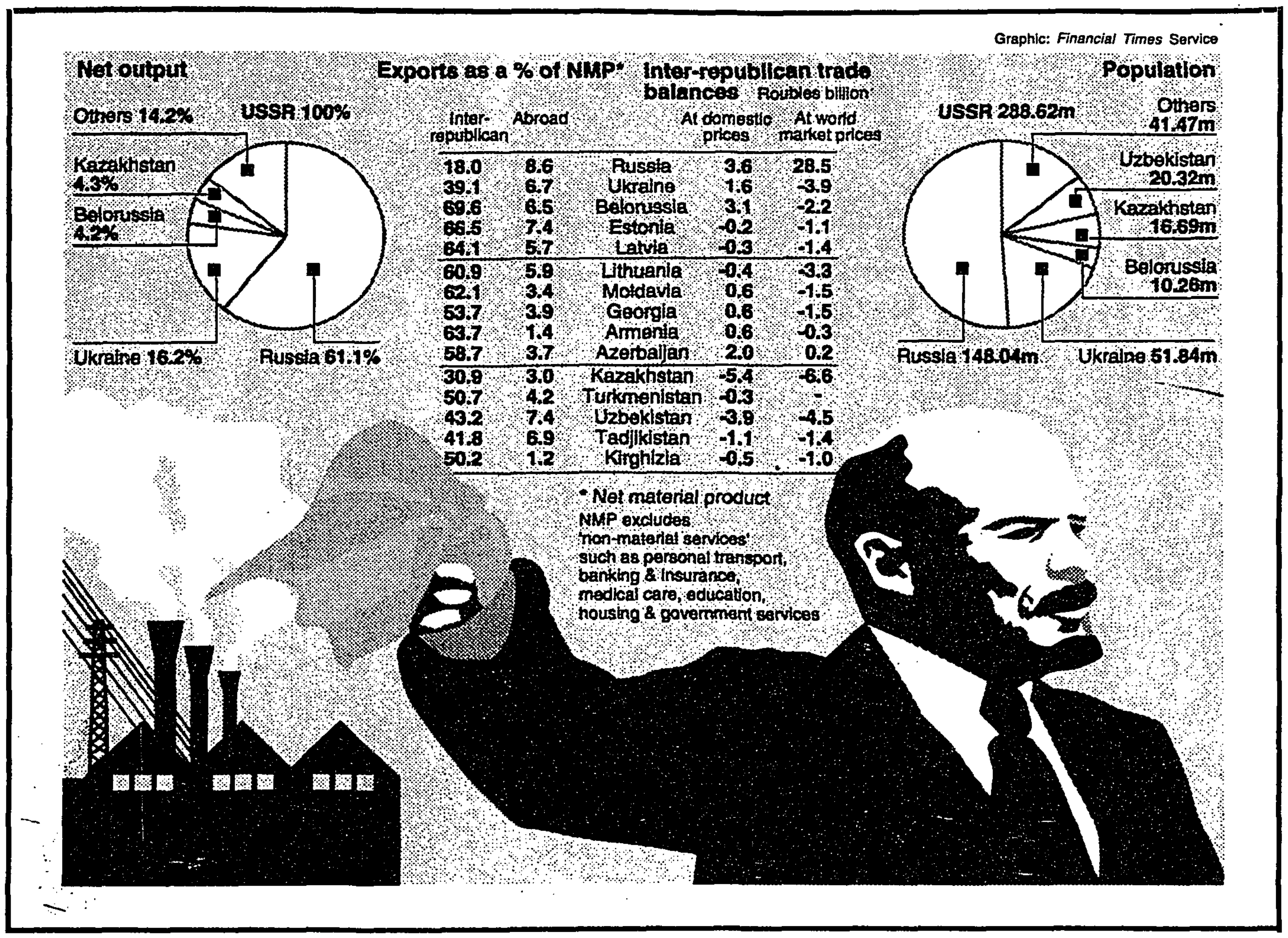
CRISIS IN THE SOVIET UNION

The financial implications of a disintegrating union

Breaking up is hard to do

Martin Wolf argues that political autonomy for the republics could lead to the disintegration of the Soviet economy



	Exports as a % of NMP: Inter-republican	Exports as a % of NMP: Abroad	Inter-republican trade balances: At domestic prices	Inter-republican trade balances: At world market prices
Russia	18.0	8.6	3.6	28.5
Ukraine	39.1	6.7	1.6	-3.9
Belorussia	69.6	6.5	3.1	-2.2
Estonia	66.5	7.4	-0.2	-1.1
Latvia	64.1	5.7	-0.3	-1.4
Lithuania	60.9	5.9	-0.4	-3.3
Moldavia	62.1	3.4	0.6	-1.5
Georgia	53.7	3.9	0.6	-1.5
Armenia	63.7	1.4	0.6	-0.3
Azerbaijan	58.7	3.7	2.0	0.2
Kazakhstan	30.9	3.0	-5.4	-6.6
Turkmenistan	50.7	4.2	-0.3	-
Uzbekistan	43.2	7.4	-3.9	-4.5
Tadjikistan	41.8	6.9	-1.1	-1.4
Kirghizia	50.2	1.2	-0.5	-1.0

THE defeat of last week's attempted coup and the end of the Communist Party's hold on Soviet life were the easier of the herculean labours facing the peoples of the Soviet Union. Now comes the hard part: reforming the Soviet economy in the midst of catastrophic collapse and apparently irresistible pressures for political dissolution. Can it even be done and what, if any, role should the West play?

The question of Western aid must at last be addressed. Contrary to the bleating, largely from the left, about the West's failure to support Mr Gorbachev, the topic was not worth serious discussion until now.

The view that greater assistance to the Soviet Union would have prevented the coup is politically implausible and economically illiterate. In the pre-coup Soviet Union, where shortages and growing economic disarray were the result of suppressed hyperinflation and the collapse of central planning, aid would have been worse than useless. It would have made it still easier for the hierarchy to postpone changes that it was evidently unwilling to make.

All has now changed. The old communist power structure committed suicide last week. The power of the Communist Party apparatchiks to obstruct reform, the capacity of the military to extract resources and the determination of the KGB to intimidate private entrepreneurs have all gone. Like the countries of eastern and central Europe before it, the Soviet Union can at last embark on serious reform. Unfortunately, the revolution that has made an economically successful reform politically conceivable has also made it technically still more difficult.

The difficulties are not just the well-known ones: the breakdown of central planning, the collapse of fiscal and monetary discipline, imminent hyperinflation, the disappearance of virtually all wage discipline and the growing risk of default on the Soviet external debt. In these respects the situation is dreadful, but not far worse than in Poland in 1989. Such a crisis can even be a stimulus to reform rather than an obstacle.

Nor is the difficulty the hostility to entrepreneurs, excoriated as "black marketeers" and "speculators", and the ignorance, throughout society, of what a market economy is and how it works. Even in these respects the Soviet Union may not be that much worse than other post-communist countries. What makes transformation of the Soviet Union almost uniquely difficult is that on top of the adjustment from the old economy to the new, which experience in eastern and central Europe has shown will be protracted and severe, now comes the disintegration of the Soviet Union itself.

President Gorbachev argues that "all the logic of our lives for centuries of history show that splitting apart . . . would be death for our people". He is right. A breakdown in internal commerce within the Soviet Union, coming on top of the 10-20 per cent decline in gross domestic product already likely this year, would inflict something close to economic death. There might and, in theory, should be economic life after such death. But the consequences of internal economic collapse for inter-ethnic and inter-republican conflict are terrifying.

A paradoxical feature of the present rush for the exit is that the dominance of Russia, which is what the other republics fear, is why it alone can contemplate economic disintegration with equanimity. Responsible for 61 per cent of net Soviet output and 90 per cent of its output of oil, possessing three quarters of its area and half of its population, the Russian Federation is the colossus among pygmies. With exports to other republics at 18 per cent of net material product (see chart) in 1988, the disintegration of the Soviet Union would be very painful for Russia, but it could survive, even in the short to medium term.

For the other republics, however, the adjustment would be traumatic. This is true even of the Ukraine, though it is a good-sized republic of 52 million people — 18 per cent of the Soviet population — and generates 16 per cent of net Soviet output. Together, Russia and the Ukraine make up the bulk of the Soviet Union, with 80 per cent of its output and area and almost 70 per cent of its population. The addition of Belorussia and Kazakhstan brings the total to 86 per cent of Soviet output.

Yet even relatively important republics could be devastated by a Soviet economic disunion. Exports to other republics were equal to 31 per cent of Kazakhstan's net material product in 1988 (and perhaps about 22 per cent of its gross domestic product). Inter-republican exports accounted for 39 per cent of Ukraine's net material product; for Belorussia the corresponding figure was 70 per cent, highest of all the Republics, though not much higher than for several others.

Colossus among pygmies

Even such figures understate the effects of a collapse in inter-republican commerce in this economy. The joint report from four international agencies, released at the end of last year laments that "an estimated 30-40 per cent of total industrial output is accounted for by products for which there is but a single manufacturer."

The internal commerce of the Soviet Union must be sustained, whatever happens to its political arrangements. This should be an overriding objective of the republics of the Soviet Union. It must be a big concern of the West as well.

Yet the survival of such commerce is far from guaranteed. On the contrary, between independent states with comprehensive controls over their economies and no common or convertible currency, the collapse of trade is almost certain. Controlled economies always tend towards autarky. In the Soviet case — where one of the main reasons for the search for monetary independence is to provide republican resources from the rouble — a shift towards republican autarky is still more likely. Such moves have already played an important part in the economic decline of the past two years and would make it still worse in the future.

The hierarchical structure of central planning was one way to organise internal trade. Horizontal links among profit-seeking enterprises are the only other one. If moves to the market were important before the coup, they have now become vital.

Only on the basis of private property and free trade is there hope of sustaining economic links among the constituent republics of the Soviet Union. To the extent, therefore, that republican autonomy is sought by old-style communists as a way of maintaining their position, the chances of maintaining inter-republican trade are significantly diminished.

Market relations and free trade among the republics must, therefore, be an essential element in any modified version of the flawed Union Treaty, whose signing was rudely interrupted last week.

Equally important, however, is the absence of internal exchange controls. Yet with many republics thinking of issuing their own currencies as a replacement for the rouble, such controls would seem inevitable. With the rouble becoming worthless, the peoples of the Soviet Union need a new monetary constitution.

Probably the best alternative would be to make the rouble a common Soviet currency backed either by commodities or by foreign exchange. Such a currency would by definition not be prey to political manipulation either by the centre or by any republican government. It could only be introduced after devaluation (and inflation) of the current rouble, or after demonetisation of a part of the existing monetary stock. There could then be no monetary financing of fiscal deficits, be they at the centre or republican levels.

Need for reform has increased

Such an outcome could also be achieved, at least in theory, by adopting the draft treaty on economic and monetary union of the European Community. But who would have confidence in any Soviet *money imposed by fiat?*

An inferior alternative would be to make the rouble the currency of Russia alone. The Russian Government would be responsible for maintaining its internal value (again after dealing with the overhang and eliminating monetary financing of fiscal deficits). Currencies of the other former republics would then have to be convertible into the rouble (though not necessarily at a fixed exchange rate). Such an arrangement would, in effect, replicate the exchange rate mechanism of the European Monetary System. (It may be noted that, under such an arrangement, once one currency is made convertible into non-Soviet currencies, they would *all* be).

In addition, the fiscal crises of the Soviet Union and the republics must be resolved. How precisely this is done would have to depend on whether any central government would retain substantial responsibilities. But internal trade could probably not be sustained in the short term without inter-republican fiscal transfers. One only has to look at what would happen to the trade balances of Russia and the remaining republics following a move towards world prices.

The obstacles to radical reform presented by the old central government may have largely collapsed. But the disintegration of the Union has increased the need for reform, while making it more difficult. A treaty creating an economic union is essential. Without it, the Soviet economy faces a collapse which could make what has happened in eastern Europe look like a mild recession.

Given the political dangers, the west cannot be a mere bystander. On the contrary, it should make clear its willingness to supply substantial assistance. But that assistance must be predicated on the maintenance of economic union. Western aid must not be offered as a prop to republics that inflict upon themselves the unnecessary wound of precipitate and ill-considered withdrawal from economic relations with the rest of the Soviet Union.

The Baltic States may, by virtue of their history and their location, be a special case. But, for the rest at least, a viable plan for an economic and, if possible, a monetary union must be agreed and implemented. On this point, President Gorbachev deserves — and should be given — strong western support. — *(Financial Times* Service).