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ECONOMIC ASSISTANCE FOR THE FORMER REPUBLICS OF
THE SOVIET UNION: A STRATEGY FOR THE WEST

AN INDIVIDUAL STUDY PROJECT

by

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INTRODUCTION

The pace at which the Soviet Union disintegrated during 1990 and 1991 shocked even the most adept Sovietologists. The dissolution of empires is supposed to occur over decades or centuries, not a span of months. Events were so rapid and unexpected that the West had no strategy for dealing with its defeated cold war adversary.

As events have unfolded, one question has repeatedly perplexed the West. What type, if any, of economic assistance should be provided to the now independent republics? The issues surrounding economic assistance are complex and consensus will be difficult to reach. Deciding to aid a former adversary is difficult under any circumstances. However, when the adversarial relationship has spanned over 70 years, the decision is understandably clouded with emotion.

The United States Secretary of State, James A. Baker, III recently summarized the views of many Western leaders:

"We are not the leaders of this revolution, but neither are we mere bystanders; we are the models for its leaders, we are the partners in its progress, and we can be the beneficiaries of its success for decades to come....Much as we will benefit if this revolution succeeds, we will pay if it fails."

If Secretary Baker's assessment is accurate, then the policy the West should follow is apparent. It is in the strategic interest

of Western nations to provide coordinated economic assistance to former Soviet republics that adopt market economies and democratic values.

Economic assistance can be defined as those measures that will (1) ensure diminished hardship and survival of the population in the short-term and (2) stabilize the macroeconomy to permit recovery and long-term prosperity through sustained growth. A number of economic assistance plans for the republics of the former Soviet Union have been offered by economists and Western political leaders. Such plans vary in their scope and complexity, but all are designed to bolster the beleaguered economies of the former Soviet republics. Thus the objective of this paper is to offer insight into current economic conditions and to present an economic assistance plan that will be both equitable and effective. In accomplishing that objective, the remainder of the paper will discuss (1) the current state of the republics' economies, (2) reasons why the West should help, (3) the type of economic assistance that is warranted and (4) the potential consequences of failure.

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THE STATE OF THE SOVIET ECONOMY

THE PATH OF DECLINE

When the Soviet Union was founded in 1922, Joseph Stalin described the landscape: "devastated fields, factories at standstill, destroyed productive powers and exhausted economic resources..."² That observation was prophetically descriptive of the union's remnants almost seventy years later. Many contend that the seeds of its demise were sown at conception. However, the most dramatic evidence of economic failure came in the last ten years of the union's life.

Economists subscribe to various theories on the disintegration of the Soviet economy. One writer has even argued that the isolated Soviets were lured into lethal economic contact with the West by inflation and rising oil prices.³ Whatever the factors, there is one point on which most economists agree - the Soviet economy was in serious trouble when Mikhail Gorbachev came to power in March 1985.

Mikhail Gorbachev ascended through the ranks of the Communist Party and had a sound understanding of his country's vast economy. He was convinced that nothing short of a restructuring, "*perestroika*," would salvage the stagnant economy. He was also convinced that to open minds and energize the populace, an era of openness (*glasnost*) would have to commence. Unfortunately, adoption of *glasnost* far out-paced that of *perestroika*. *Glasnost* permitted open challenge to authority which was clearly incompatible with the traditional Soviet

command economic apparatus. The result has been described by noted Harvard economist, Jeffrey Sachs:

"Workers and managers raked off enterprise income that used to go to government, while the authorities tried to buy social peace through bigger consumer subsidies and welfare spending. Budget deficits soared, and were covered by printing rubles. Meanwhile, enterprises were given access to cheap bank credits, with little overall control. The money supply expanded relentlessly, accelerating sharply in 1991."⁴

Economic conditions and Communist Party authority deteriorated in the Soviet Union almost symmetrically during the Gorbachev years. On August 19, 1991, tanks rolled through Red Square in a last-ditch effort by Communist "hard-liners" to hold the empire together. Whatever the motives of the eight members of the "State Emergency Committee," there is little doubt that a primary catalyst of the failed coup was a reaction to the severe economic crisis.

In the months following the aborted coup, the last vestiges of Communist control in the Soviet Union evaporated. One-by-one the various republics declared their independence. Finally, on December 8, 1991, the Presidents of Russia, Ukraine and Belorussia (the three founding republics of the old union) signed the death certificate for the Soviet Union: "The Union of Soviet Socialist Republics as a subject of international law and geopolitical reality, is ceasing its existence."⁵ In an effort to maintain a semblance of economic cohesion, the three republics were joined by eight others in the formation of the "Commonwealth of Independent States" (CIS).

The CIS has not proven effective in maintaining economic and political ties between the republics. Economic hardships and old rivalries have combined to create an atmosphere of mistrust and outright hostility between the member states. The Russian government has refused to supply Ukraine and the others with fresh supplies of rubles desperately needed to pay the workers in state-owned enterprises.⁶ The republics of Ukraine and Belarus are making plans to issue their own currencies and inter-republic trade has declined to a fraction of its former level.⁷ Ukraine recently accused Russia of engaging in "Imperial" policies and charged the Russians had frozen Ukrainian hard currency assets of \$425 million in Moscow banks.⁸ Members of the commonwealth have little in common except designs on the other's meager wealth. The relationship is hardly a prescription for economic recovery.

THE CURRENT ENVIRONMENT

One of the most dramatic indicators of economic collapse in the republics is the spiraling rate of inflation. Even before recent price deregulations in the Russian republic, inflation across the former Soviet Union was running at about 450 percent annually.⁹ A root cause of inflation has been the government's requirement to cover tax receipt shortfalls by printing additional currency. During 1991 the Soviet money supply increased 340 percent as the former central government increased its budget deficit to 300 billion rubles.¹⁰ By contrast, the

United States' money supply rose only about 3 percent during the same period.¹¹

Declining productivity has further exacerbated the inflationary spiral. Soviet Gross National Product (GNP) fell by 15 percent in 1991. Industrial production, which rose throughout the 1980's, fell by 2 percent in 1990, and between 8 and 10 percent in 1991.¹² Implementation of reforms will likely further impact productivity. Since Polish authorities applied economic "shock therapy" in 1989, output has declined and unemployment has increased to 12 percent of the Polish work force.¹³

Economic features from the Stalinist system are threatening to further erode industrial productivity. Under the old Soviet system, a single enterprise could account for 60 to 100 percent of the country's output for a specific commodity.¹⁴ Factories that manufactured the components of products such as automobiles were often located in different republics. The present lack of economic cooperation between republics is idling workers and closing factories across the former Soviet Union. For example, the Minsk automobile plant in Belarus has virtually shut down due to inability to import such vital components as engines and electrical parts from plants in Russia and Ukraine.¹⁵

In no sector is Western assistance more urgently needed than that of agriculture. Even though the Soviet Union invested almost 30 percent of its GNP into the agricultural sector during the last decade, output fell by more than 20 percent in 1991.¹⁶

The system remains very inefficient due to an inadequate infrastructure and severe shortages of fertilizer, machinery, spare parts and fuel.¹⁷ Experts estimate that 25 percent of state owned farms have inadequate roads and almost 40 percent have no storage facilities.¹⁸ Soviet Agriculture uses nine times more labor, 40 percent more land and 50 percent more fertilizer than the United States' agricultural system. Yet the United States produces 25 percent more grain than the former Soviet Union.¹⁹

Inefficient agricultural productivity is exacerbated by inability to properly distribute food that is produced. The former Soviet Union was rife with poor roads and an insufficient number of refrigerated trucks and food processing plants.²⁰ Experts estimate that one-third of the harvest is lost (primarily through spoilage) in transit between Soviet farms and markets and almost 40 percent of perishable goods are lost or spoiled before reaching consumers.²¹ Timothy Ash of the University of Exeter estimates losses for some fruits and vegetables run as high as 70 percent.²² Facing severe food shortages in the fall of 1991, the former central government asked the European Community for \$7 billion in emergency food assistance. The request included 5.5 million metric tons of grain and 900,000 metric tons of meat.²³

During the first quarter of 1992, the ravaged economies of the republics sank to new depths. Wages and pensions lagged far behind newly deregulated prices, and most Russians were left wanting for common staples they could no longer afford. Even

Mikhail Gorbachev was forced to subsist on a monthly pension of \$56.²⁴

Economic conditions worsened as severe fuel shortages closed half the airports and grounded domestic flights.²⁵ More than 8,000 oil wells stood idle, a reflection of more than a 10% reduction in energy output. Russians could not fully comprehend the political changes that 1991 had brought, but could "see with their own eyes how the fabric of daily life had been torn to shreds by six years of political and economic upheaval."²⁶

WHY THE WEST SHOULD HELP

In deciding the wisest strategy for aiding the former Soviet republics, Western leaders must weigh their national and collective interests. If these interests include proliferation of democracies and free market economies, furthering their own well being and ensuring stability throughout Eurasia, then the strategy becomes apparent. Western nations should provide economic assistance to the former Soviet republics because assistance (1) is essential to survival of the best leadership alternatives, (2) has succeeded in the past, (3) is in the collective and individual economic interest of Western nations, and (4) is vital to ensuring stability in the region.

THE BEST HOPE

Current Russian Republic President Boris Yeltsin emerged from the August 1991 coup as the strongest political force in the

Soviet Union. As leader of an independent Russia, he has continued to demonstrate remarkable political courage. He has surrounded himself with the brightest economic minds in Russia. Together they have embarked on a bold market reform program of "shock therapy" similar to that employed in Poland in the late 1980's. As former President Richard Nixon recently observed, "If Yeltsin's reforms fail, no successor will be able to do any better."²⁷

Ukrainian president, Leonid Kravchuk, is also aligning himself with bright economic talent. He has selected Oleksandr Savchenko as his chief economic advisor.²⁸ Savchenko studied government finance at Harvard, courtesy of a Ukrainian-American organization. He also spent time at the New York Stock Exchange, the U.S. Department of Treasury and the banks of the Federal Reserve System. Since he was the only Ukrainian with an understanding of how a central bank functioned, he was named Deputy Chairman of the newly formed National Bank in Kiev.²⁹ Having trained and educated Savchenko (and his counterparts in the Russian republic), the West has a stake in their success or failure.

As important as success in Ukraine and the smaller republics may be, the keys to overall reform of the former Soviet Union remain the Russian republic and its leadership. Russia's population comprises over 50 percent of the former Soviet Union and more than 75 percent of the land mass. These features, coupled with the strength of its leadership, have made it the

most influential of the republics in its approach to economic and political reform. Fortunately for the West, it has chosen an aggressive approach to reform its political and economic institutions along Western lines. The other republics have generally followed Russia's lead in implementing reforms such as price liberalization. If Russian leaders fail, leaders of the remaining republics will be reluctant to implement needed reforms.³⁰

Harvard economist Jeffrey Sachs is a senior advisor to the Russian Federation government and one of several foreign economists advising Yeltsin. He has described the current efforts in Russia as "politically very risky"³¹ and "like jumping out of an airplane while you are still sewing the parachute...(however)...they have no choice, the plane's crashing."³² The West has little time and no margin for error to ensure that Yeltsin has plenty of thread for the parachute.

PAST ECONOMIC ASSISTANCE

Taking care of defeated adversaries or struggling allies is not a new phenomenon. Although motives often vary, history is replete with examples of assistance programs. The United States experienced great success in providing assistance to the Soviet Union and Western Europe in the past.

Strong comparisons can be drawn between conditions in the Soviet Union today and those in 1921. Deteriorating economic conditions prompted worker, peasant and sailor revolts in March

of that year. Lenin was forced to abandon policies of "War Communism," as he reintroduced market reforms. However, reforms came too late to avert widespread famine. In response, Herbert Hoover, Secretary of Commerce, directed the American Relief Administration (ARA) to provide aid to the Soviet Union in one of the most successful humanitarian efforts ever undertaken. The ARA and other volunteer agencies fed more than 20 million Russians, providing tons of clothing and more than 166,000 tons of vital seed grain. After 70 years, many Russians still remember the ARA's efforts and the lives it saved.³³

Another successful assistance program was the Marshall Plan for Western Europe. The Marshall Plan was implemented in the aftermath of World War II as part of the United States' strategy to prevent the further spread of communism in Europe. Sixteen European countries took advantage of the program between 1948 and 1952, and accepted more than \$13 billion in economic assistance. Recipient countries' GNP rose by 25 percent in real terms during the period. Industrial production increased by 35 percent and agricultural production by 10 percent.³⁴ As a result, the United States ensured the economic strength and future of its present day military allies and economic trading partners.

Analysis of the Marshall Plan reveals that it cost the United States only five percent of one year's GNP over a four-year period. This equals \$71.3 billion in present dollars. Conversely, a similar percentage of the collective GNP of the 24 members of the Organization for Economic Cooperation and

Development (OECD) would yield almost \$1 trillion over four years. This far exceeds any proposed assistance for the republics. However, it does confirm that any conceivable aid proposal would represent a much smaller relative cost on the part of donors than did the Marshall Plan.³⁵

ECONOMIC INTERESTS

There are enormous opportunities for those nations willing to invest in the resource-rich republics of the former Soviet Union. Heritage Foundation foreign policy analysts believe that Soviet prosperity "will increase the probability that nascent democratic institutions will survive, and will mean greater investment opportunities for American businesses and huge, new markets for American exports."³⁶ Other Western nations such as Germany certainly realize the potential for success. For example, German investors are concluding a number of deals with the republics including arrangements to convert defense plants to nonmilitary uses.³⁷ Many critics of the United States' lack of response to the republics' plight, charge that it is "frittering away its leverage" while more proactive nations gain influence.³⁸

Oil is one vital resource the United States could tap in the region. The former Soviet Union produced one-fifth of the world's daily oil output.³⁹ An aggressive program by the United States and its oil industry to resurrect the Soviet oil industry could pay long-term dividends. Vast energy supplies flowing to the West from former Soviet republics would reduce dependence on

unpredictable supplies from the volatile Middle-East and serve to hold down overall cost of energy.

Another area of economic potential is technology. The high-technology enterprises that were formerly part of the Soviet military-industrial complex offer particularly lucrative opportunities for Western firms. Many of these formerly state-owned enterprises are desperately seeking joint-ventures.⁴⁰ For example, the plants that manufacture the world's largest airplane (An-225 *Mriva*) and the largest transport helicopter (Mi-26) have concluded arrangements with American firms to produce these aircraft for sale on the world market.⁴¹ If the United States government does not encourage its industry to invest in the former republics, other Western nations undoubtedly will. This could seriously undermine the United States' competitive advantage in high-technological industries such as aerospace, computers, nuclear engineering and electronics.

REGIONAL STABILITY

Perhaps the greatest Western interest to be served by providing economic assistance to the former Soviet republics is the potential for enhancing stability in the region. European nations already recognize the potential threat that unstable republics can pose and are developing economic assistance policies to forestall that potential. Three plausible scenarios resulting from regional turbulence include: (1) a flood of refugees from the republics into Europe; (2) armed conventional

conflicts between one or more of the former Soviet republics; and, (3) nuclear confrontation.

One of the enduring images of communism's world-wide collapse has been the flood of refugees scaling walls and clinging to ships to escape the misery. While the Soviet collapse has not yet produced such spectacles, severe near-term food shortages could produce such events. Germany has been particularly sensitive to the prospect, and Chancellor Helmut Kohl has been the most vocal Western advocate of direct financial assistance to alleviate Soviet suffering.⁴²

A recent article in The Economist summed up the potential for internal strife within the Soviet Union: "When empires break up, their most poisonous legacy often proves to be borders that were arbitrarily determined by the imperial ruler. Strife among ethnic or religious groups follows, condemning newly independent countries to political and economic failure from the outset."⁴³ Such could be a prescription for the former Soviet republics if unable to resolve their differences. To preclude this from the outset, the West should serve as the mechanism to foster peaceful coexistence between the republics. Western economic assistance should be predicated on commitment to peaceful coexistence with neighboring republics and countries. In response to the prospect that some of the republics are arming themselves for war against each other, Secretary of State Baker stated, "Those who pursue these misguided and anachronistic policies should know that they will receive neither acceptance nor support from the West."⁴⁴

Although still viewed as a remote possibility, the prospect of nuclear confrontation is not ruled out by many observers. Barry Schneider, Director of National Security Studies for The Harris Group, observed that many unimaginable things have happened recently in the Soviet Union, and the prospect of a Soviet nuclear civil war is not out of the question.⁴⁵ Some 30,000 nuclear weapons were scattered across the 15 republics of the old Soviet empire at the time of its demise. The majority are still functional. The same factors that might provoke a conventional civil war could conceivably lead to nuclear engagement.

Some political elements within Russia are offering proposals that would severely destabilize the region (if not the world). Vladimir Zhirinovsky, the chairman of Liberal-Democratic Party in the Russian republic, has proposed solving food shortages by invading the former East Germany with an army equipped with nuclear weapons. As a minimum, Zhirinovsky wants to reclaim Russian territory to the pre-Bolshevik borders of 1913. But, he was recently quoted as stating: "...the ideal variant is to return to the borders that existed 130 years ago in 1865, when Alaska was part of our state, and our state stretched over three continents."⁴⁶ Zhirinovsky ran third in the June 1991 Russian presidential election, garnering almost 6 million votes. Time magazine recently observed that some pundits fear Zhirinovsky "may be a forerunner of politicians to come."⁴⁷

The West should not be compelled to provide economic assistance purely out of extortion or fear. However, the prospects for a prosperous and stable region that will peacefully coexist with the West must certainly be a motivating factor in providing the needed aid.

A PLAN FOR REFORM AND ASSISTANCE

The issues involving Western economic assistance are complex. Economic changes in the former Soviet Union have been underway for several years and some Western assistance has already been provided. However, as noted in The Economist recently, the West has adopted no "coherent plan of action" thus far.⁴⁸ This section presents an economic assistance plan through which the West can aid the former Soviet republics by: (1) reviewing the assistance provided thus far; (2) delineating steps the republics must take to warrant assistance; (3) itemizing elements the West should incorporate in a long-term plan; and, (4) examining a plan for sharing the cost of assistance.

ECONOMIC ASSISTANCE TO DATE

Western nations have not sat idly by during the Soviet economic collapse. While their response has been largely uncoordinated, it has been extensive. Western governments pledged almost \$80 billion to the former Soviet republics between September 1990 and January 1992. Of that, 57 percent was pledged

by Germany⁴⁹ and 21 percent by other European nations; less than 10 percent came from the United States and Japan.⁵⁰

Of the \$80 billion of Western economic assistance, 48 percent was in the form of export credits and loan guarantees. Of the remaining 52 percent, 14 percent was for other credits, 13 percent for strategic assistance, 10 percent for balance-of-payments support, 4 percent for food and medical aid and slightly more than 2 percent for technical assistance.⁵¹ During 1991, the United States provided the Soviets 18 million tons of food and granted \$4 billion in food and grain credits.⁵²

In response to mounting criticism and worsening economic conditions in the republics, in January 1992, the United States convened an international conference on economic assistance to the former Soviet republics. President Bush opened the 47-nation conference with an announcement that he would ask the United States Congress for an additional \$645 million in humanitarian and technical assistance for the republics. Facing worsening economic conditions in their own countries, conference attendees presented little in the way of new proposals or coordinated strategy for economic assistance. The United States only offered additional humanitarian assistance, Germany complained that the United States should do more, France complained that officials from the republics were not invited and Japan dismissed the prospect for additional aid until outstanding territorial issues are resolved.

The advent of additional humanitarian assistance was attended by great fanfare on the part of the United States. The Secretary of State was on-hand as the first of 64 flights left Air Force bases carrying emergency food and medical supplies to 23 locations across the former Soviet Union. However, the foodlift provided little in the way of relief. The food delivered to Moscow, for instance, lasted only two nights in soup kitchens.⁵³

IMPLEMENTING REPUBLIC REFORMS

Proposals for assisting the former Soviet republics are varied and complex. Numerous economists, politicians and diplomats have offered assistance packages for Western consideration. The issues are contentious and very few proposals are identical. However, one approach that appears to have the best chance for Western support and long-term success involves "mutual engagement" between former Soviet republics and Western nations willing to help. Under this approach, championed by Graham Allison and others, the republics would implement specific economic and political reforms and the West would respond with specific assistance.

Economists differ on reforms they consider most crucial to recovery of the republics' economies. Some proposals offer detailed suggestions while others deal primarily with macroeconomic theories. However, there are at least three basic reforms considered fundamental for successful conversion to

market economies: (1) liberalize price controls; (2) privatize property; and, (3) permit free trade and foreign investment.

LIBERALIZE PRICE CONTROLS

A basic feature of the Soviet command economic system was state mandated prices for all goods and services. As the central government printed rubles to cover deficits in the late 1980s, the money supply exceeded the supply of goods available. As a result, shelves were bare and a huge underground economy evolved to allow for a free exchange of goods and currency. When the state permitted prices to rise to attract goods back to the official economy, inflation resulted.

Boris Yeltsin and his economic advisors recognized early on that recovery in the Russian Republic would require free prices in the marketplace. On January 2, 1992, prices were freed from controls on "all but a few politically sensitive goods" for the first time in 70 years.⁵⁴ Ukraine, Belarus and the other republics reluctantly followed suit.⁵⁵ The immediate result was a shock to the average citizen. The price of sausage, for instance, increased overnight by more than 1,000 percent. Following price increases in the republic of Kazakhstan, more than 80 percent of the population fell below the poverty line.⁵⁶ Yeltsin and his advisors are predicting that the money supply and consumer demand will reach equilibrium within six months (others disagree), thus curbing inflation and invigorating the private sector.⁵⁷

No aspect of "shock therapy" carries more risk than price liberalization. Critics of price deregulation were vocal before January 2nd 1992, and the reaction since has been highly volatile. Leaders of some republics have retreated from their initial support of full deregulation. Nonetheless the West must insist on price liberalization as a condition for economic assistance. Hyperinflation and commodity shortages do not create an attractive investment opportunity for Western enterprises.

PRIVATIZE PROPERTY

The republics must also privatize property. Private property is an essential element of a market economy and a prerequisite for Western investment in the republics. Graham Allison has put the issue in perspective:

"The lesson of Eastern European economic reform in the 1980's is that partial reform focused on decentralization of economic decision-making or on macroeconomic stabilization will fail in the absence of positive incentives that come from private (property) ownership and competition..."⁵⁸

Once again, the most ambitious reformers in the republics have accepted the challenge. As early as 1990, the Russian parliament began enacting laws on private property, housing, land and industrial privatization. In December 1990, a new law gave Russian farmers the right to own their own land. During 1991, more than 30,000 private farms were created in Russia.⁵⁹

Another bold reformer is Kazakhstan's President Nursultan Nazarbayev. He recently issued a sweeping decree for

privatization of his republic's agricultural industry. Under this directive, all agricultural enterprises in Kazakhstan will be privatized by March 1, 1993. Those enterprises that are marginally profitable or are losing money will be privatized by July 1, 1992.⁶⁰

A number of other republics have also begun implementing privatization. The Supreme Council of the Republic of Uzbekistan recently passed a resolution on "Destatization and Privatization" of property.⁶¹ In addition, the Ukrainian Parliament recently approved a "General Outline of Denationalization and Privatization of Enterprises, Land, and the Housing Stock."⁶² The Parliamentary initiatives in Uzbekistan and Ukraine are not as progressive as those of Russia or Kazakhstan. However, their recent adoption reflects evolving recognition by the republics of the importance of privatization in an overall plan of reform.

Republic governments face formidable tasks. By some estimates, there were 46,000 large state enterprises and 750,000 state-owned shops within the old Soviet Union. In addition, the republic governments still own almost 50 percent of the housing.⁶³ Privatization of businesses will be even slower. As of February 1992, only 170 shops in Moscow had been privatized.⁶⁴ Bureaucratic traditions die hard and officials administering the privatization program in Russia are clinging to the economic traditions of the old Soviet Union. Anatoli Tatarintsev, director of a Moscow store, recently described the process of

privatizing a business: "You fill out a pack of documents and then they ask for more."⁶⁵

Western governments, such as Great Britain, have sold state-owned enterprises to the private sector, but never has divestiture occurred on such a large scale. A dire lack of wealth by former Soviet citizens will compound the challenge. The governments will have to transfer ownership to their citizens without significant payment. The process will be long and complex and privatization of larger enterprises will take years to complete.⁶⁶

FREE TRADE AND FOREIGN INVESTMENT

The third element of economic reform is permitting free trade and foreign investment. Again, the Russian republic has taken the lead in implementing reforms. In a recent speech before the Congress of People's Deputies of the Russian Republic, President Yeltsin stated:

"We shall rebuild the foreign-trade system on international patterns...Russia needs foreign investment to revitalize its economy. We are prepared to negotiate with the international community measures to be taken to create a favorable economic environment for foreign investors and hope for financial support from abroad."⁶⁷

In addition, the Russian republic is promoting additional trade with the West. It has begun the competitive sale of import and export licenses. A number of Russian firms, including former defense plants, are working on joint-venture projects with Western firms.

Russia is not alone. Almost all of the former Soviet republics are seeking foreign investment. The Ukrainian parliament recently adopted a foreign investment law that allows foreign ownership of Ukrainian property. In order to attract additional foreign investment, the law provides that all joint enterprises operating in Ukraine are exempt from tax for five years.⁶⁸ The President of Armenia has also recognized the value of foreign investment. He recently issued a directive "with the aim of accelerating economic reforms and stimulating foreign economic activity and foreign capital investments in the Republic of Armenia."⁶⁹

Western investment in the former Soviet republics will not be automatic. Measures and reforms besides those above will be required if the republics are serious about attracting Western investment. These measures include (1) stabilizing the macroeconomy through reductions in government spending and banking reform, (2) implementing a market oriented legal system including such elements as contract law, copyrights and patents, and (3) limiting direct government intervention in the economy.

HOW THE WEST SHOULD HELP

If the West follows the Allison strategy of "mutual economic engagement," then providing assistance to the former Soviet republics should be a function of their implementing the reforms discussed previously. The timing and amount of assistance should be geared to ensure success of each of the elements of reform.

At a minimum, the West should help the former republics with (1) a currency stabilization fund, (2) balance of payments support, (3) private sector development and (4) technical assistance.

CURRENCY STABILIZATION FUND

The collapse of the ruble has been dramatic. In 1985, the ruble was worth about 84 cents at "official exchange rates".⁷⁰ Today it is worth less than 1 cent.⁷¹ The decline reflects a total lack of confidence in the ruble by citizens of the republics and the West, and its recovery will be essential to economic stabilization. The West should finance currency stabilization to support the ruble as it did for Poland in early 1990. In that instance, the West made available to the central bank a stock of foreign exchange reserves for sale to the public at the prevailing exchange rate.⁷²

There are alternative proposals for rescuing the ruble. Sir Alan Walters, former economic advisor to Margaret Thatcher, has proposed the introduction of a "new ruble," the value of which would be underwritten in part by the West.⁷³ Walters believes that the new currency would require some \$30 billion in hard currency reserves. However, he proposes that the republics absorb a portion of the cost by contributing their gold supplies to the reserves.⁷⁴

A more practical approach to stabilizing the currency involves "rescuing" the existing ruble. Under this approach, the West would provide foreign exchange reserves that would be

available to the central bank for sales to the public at the prevailing free exchange rate. Economists view the fund as a confidence building device that ideally would not be drawn against.⁷⁵ As confidence in the ruble rebounds, its decline against Western currency would be diminished. The West could treat the contribution as a loan, and withdraw their funds after long-term stability of the ruble is assured.

Boris Yeltsin and his advisors believe that a currency stabilization fund is the most important contribution the West can make to the Russian republic.⁷⁶ The leadership in the West appears to be reaching the same conclusion. Secretary of State Baker, recently indicated that currency support from the United States and other Western Nations might be needed to supplement assistance from the International Monetary Fund (IMF) and the World Bank. However, Baker cautioned that currency stabilization assistance would only come if Russia and the other republics develop viable economic reform plans.⁷⁷

BALANCE-OF-PAYMENTS SUPPORT

The West must also provide assistance to the republics for balance-of-payments support. This would consist of financial assistance (grants or loans) or donated goods (such as food or medicine) to enable the republics to import more than they could otherwise afford.⁷⁸ Russian officials are urging Western governments to contribute as much as \$12 billion for balance-of-payments supports so that Russian shops and factories can remain

open.⁷⁹ This assistance is critical for short-term economic stability and perhaps even survival.

The primary difference between balance-of-payments support and the currency stabilization fund is that the balance-of-payments should be consumed. Adequate balance-of-payments assistance from the West would help support the ruble as it floats against Western currencies. In this regard, the two programs would be complementary, with balance-of-payments funds exerting a positive impact on declining imports.⁸⁰

The most significant contribution from balance-of-payments support would be its stabilizing effect during the most critical phase of reform. Graham Allison and Grigory Yavlinsky contend that:

"...balance-of-payments support will help to finance a trade deficit of the (former) Soviet Union in the initial stages of the reform program, so that living standards do not fall precipitously and social tensions worsen significantly during this phase."⁸¹

However, United States officials do not embrace the idea of balance-of-payments support to the former Soviet republics. One American official who recently endorsed currency stabilization fund support cautioned that it would not be used to support the imports of consumer goods.⁸²

Balance-of-payments support would be an excellent means of aiding recovery of the republics' agricultural sectors. The Christian Science Monitor recently noted that:

"...of all the sectors of the Soviet economy, agriculture is the easiest fix.... Even half the \$6.5 billion the West pledged in food credits could help buy small, versatile tractors, rototillers, trucks, grain bins, dryers, generators and small food-processing and packaging devices. [This was proven in Poland --] Polish agriculture evolved from food shortages to overproduction in two years."⁸³

Given declining agricultural output, this assistance may well prove to be critical humanitarian aid vice economic assistance.

PRIVATE SECTOR DEVELOPMENT

In addition to short-term assistance described above, the West must provide long-term help if the republics are to establish strong market economies. Unlike Western Europe at the end of World War II, the former Soviet republics have no vestiges of market economies to rebuild. The West must help the republics build a private sector through various initiatives.

Establishment of "enterprise funds" by the West is one way to aid private sector development. Such funds would function similar to those in Poland and Hungary. Their basic purpose is to promote establishment of small businesses by providing loans which average up to \$15,000. Local bankers are provided with funds and are trained in sound lending practices. These "enterprise funds" have been very successful in "promoting the market at the grass-roots level."⁸⁴

Private sector development could also be promoted by Western investment in republics' infrastructure. The transportation system is sorely in need of investment. The nuclear power industry is unreliable and unsafe and could be enhanced greatly

with Western assistance. As discussed previously, the agricultural system is vastly inefficient when compared with the West. In addition to contributing food credits and equipment, Western governments should provide incentives to their firms to invest in the former Soviet agricultural system.

TECHNICAL ASSISTANCE

Technical assistance may well be the most valuable form of aid the West can render. Almost every noted advocate of assistance for the republics lists technical assistance as a high priority. It is appealing to Western leaders because it is not as expensive as other forms of aid and involves Western industry from the outset (instead of governments).

Technical assistance is not only "high technology" machines and methods, but rather a broad term encompassing a variety of other programs designed to transfer Western "know-how" to the fledgling market economies of the republics. Jeffrey Sachs describes it as including such things as "management consultancy for newly privatized firms, establishment of business schools and economics faculties to teach market economics, (and) scholarships for ... Russian students in the West".⁸⁵

The Soviet Union functioned under a command-oriented economy for over 70 years. As Charles Lane recently observed, "structural changes are relatively easy compared with the difficult task of eliminating the residue of communist rule."⁸⁶ Any effective program of economic assistance for the republics

must include orientation and training on the management and operation of a free market economy. Western governments and industry should "team up" and dispatch experts to the republics to advise officials and entrepreneurs on how to create financial institutions and capital markets, protect private property rights, train managers and privatize state-owned enterprises.⁸⁷ The IMF and World Bank are already providing experts to show the former Soviets how to collect and interpret statistics on budgets, finances, trade and output levels.⁸⁸

THE COST

The collapse of the Soviet Union and the need for assistance by its successor states could not have come at a worse time for the West. The United States is mired in its worst recession in a decade. Our political leadership is preoccupied with high unemployment, soaring budget deficits, and a deepening concern about the economic health of the nation by the electorate. Similar problems confront other Western nations. In addition, Germany and other West European nations are already committed to assisting their East European neighbors. Unless the program is affordable and shared equitably by all Western nations, meaningful economic assistance for the former republics may never be realized.

Jeffrey Sachs recently estimated the cost of aiding the former Soviet republics. He believes that \$30 billion in aid will be needed from the West in 1992 to fund currency

stabilization, balance-of-payments support and technical assistance. Of that, \$15 billion to \$20 billion will be needed for Russia, with the rest going to the other republics. He perceives a need for similar amounts over the next three or four years.⁸⁹ No proposal approaching that amount has been surfaced by the West.

Sachs also has proposed a formula for financing the aid by Western nations and their financial institutions. Sachs proposes that assistance contributions be divided as follows:

**PROPOSED WESTERN CONTRIBUTIONS FOR
ECONOMIC ASSISTANCE⁹⁰**

<u>SOURCE</u>	<u>AMOUNT</u>
International Monetary Fund	\$ 5 billion
World Bank	4 billion
European Bank for Reconstruction and Development	3 billion
European Governments	10 billion
United States	3 billion
Japan	3 billion
Other Nations	<u>2 billion</u>
TOTAL CONTRIBUTIONS	\$30 billion

Assistance from the IMF is contingent upon membership of recipient republics. Membership in the IMF will likely be extended to Russia, Armenia, Belarus, Ukraine, Kazakhstan, Moldavia, Estonia, Latvia and Lithuania at the IMF's April 1992 meeting.⁹¹

While the total proposed by Sachs may not be realistic (given the current economic and political conditions in the West), the ratio of burden-sharing might well prove acceptable to Western governments. Whatever the total amount of assistance, the West must move forward with a coherent and workable strategy for aiding the former Soviet republics.

THE CONSEQUENCES OF FAILURE

The West stands to gain much from a successful transition of the former Soviet Union to a community of prosperous and friendly nations. However, there is much to lose if the conversion fails. Secretary of State Baker recently observed:

"Politically, the dangers of protracted anarchy and chaos are obvious. Great empires rarely go quietly into extinction. No one can dismiss the possibility that darker political forces lurk in the wings, representing the remnants of Stalinism or the birth of nationalist extremism or even fascism, ready to exploit the frustrations of a proud but exhausted people in their hour of despair."⁹²

There are a number of daunting prospects attending failure of Boris Yeltsin and other reformers. The possibility of nuclear or conventional civil war among the republics and the prospect of a flood of refugees into the nations of Europe were discussed previously. However, the greatest risk for the West is that failure of the emerging governments will bring a harsh return to unfriendly totalitarian regimes.

Former President Gorbachev expressed Soviet aspirations in his acceptance speech for the Nobel Peace Prize:

"We want to become an integral part of modern civilization, to live in harmony with mankind's universal values, abide by the norms of international law, follow the 'rules of the game' in our economic relations with the outside world."⁹³

These views have been reiterated by Boris Yeltsin and others in recent months. However, their success in achieving these goals is by no means assured. Leaders of the republics have a tenuous hold on power, and the patience of their electorate is already wearing thin. Recent protests by communists and ultra-nationalists in Moscow turned violent and left 20 policemen and seven civilians injured.⁹⁴ In Uzbekistan, six students were killed and 30 more injured in recent protests against soaring prices.

Boris Yeltsin recently warned the West that a return to dictatorship was imminent if his economic reforms failed. Recent posturing by his opponents lend credibility to his assessment. Russian Vice President Alexander Rutskoi, a hero of the Afghanistan war, recently referred to Yeltsin's reform program as "economic genocide" and he called for the resignation of Yeltsin's cabinet. In addition to threats from the present, Yeltsin is increasingly confronted with faces from the political past. Almost 200 Communist delegates of the Peoples Congress of the former Soviet Union recently defied Yeltsin and convened "The Sixth Congress" to declare the Soviet Union still alive.⁹⁵

The military of the former Soviet Union could well be a factor if Yeltsin and other leaders fail in their reform efforts. The military forces remain largely intact. The senior command

has not been purged as was expected following the failed coup. The lines of command authority between the leaders in the republics and the military forces remain vague. Yeltsin has courted the approval of military leaders by granting cost of living increases beyond those available to the average Russian.

An ominous sign of the potential failure of democratically elected governments has already been demonstrated in the republic of Georgia. There, the military removed the popularly elected president and established not only the military rule, but also the precedent within the republics for the kind of cyclical struggle that has plagued developing countries in the rest of the world.* The West cannot stand back and watch as a succession of dictators come to power in a 21st century version of "Russian Roulette." The West must move forward with assistance to ensure the republics follow paths that are in Western interests. The consequences of failure are too foreboding for the world to even contemplate.

CONCLUSION

The Cold War is over. The West triumphed over the "evil empire" that was the Soviet Union. However, the West has no post-war plan. There is no cohesive strategy for ensuring that the former adversary is rehabilitated and that it will not again pose a threat to world peace. Assisting the former Soviet republics is clearly in the strategic interest of the West and time is running out.

The West must engage in an economic assistance program for a number of reasons. The type of economic assistance needed has worked in the past, and the economic interests of the West are clearly served by developing new markets in, and tapping the natural resources of, the former Soviet Union. The stability of a region (and the world) possessing more than 30,000 nuclear warheads is at stake. And finally, those who would reform the republics are perhaps our last best hope for ensuring they become thriving free-market and democratic systems.

Once a decision is reached to provide coordinated and substantive assistance, the West must deal with the republics from the standpoint of "mutual economic engagement." The republics must liberalize price controls, privatize property and permit free trade and foreign investment. In return, the West must provide funds for currency stabilization and balance-of-payments support, assist in development of the private sector and provide technical assistance.

There is no guaranteed prescription for success; nor is it certain that the republics will fail without help. However, the risk is great. If the West does not engage its former adversary with the kind of help it so desperately needs, the opportunity to witness a "new world order" may forever be lost.

EPILOGUE

After this paper was completed, President Bush and German Chancellor Helmut Kohl made a long-awaited joint announcement on a proposed Western economic aid package for the former republics of the Soviet Union. In his April 1, 1992 address, President Bush reflected on the significance of his proposal:

"The revolution in these states is a defining moment in history with profound consequences for America's own national interest. The stakes are as high for us now as any we have faced in this century, and our adversary for 45 years, the one nation that posed a threat to freedom and peace, is now seeking to join the community of democratic nations. . . But if this democratic revolution is defeated, it could plunge us into a world more dangerous in some respects than the dark years of the cold war."⁹⁷

The program of assistance, if approved, will provide the republics \$24 billion in economic aid. Funding would come primarily from the United States, Germany, Great Britain, Japan, France, Canada and Italy. The proposal consists of \$11 billion in commodity credits and humanitarian aid, \$4.5 billion in IMF and World Bank loans, \$2.5 billion in debt rescheduling and \$6 billion for a currency stabilization fund.

A comparison of the proposal with recommendations outlined in this paper reveals that long-term recommendations were embraced while short-term recommendations were not. Establishment of a \$6 billion currency stabilization fund is clearly the most important element of the proposal. The fund will be administered by the IMF and should prove critical to short-term stabilization of the ruble. The \$11 billion for commodity assistance and humanitarian aid should alleviate short-

term suffering and provide some balance-of-payments relief to struggling economies of the republics. However, the plan does not include long-term initiatives focused on private sector development and technical assistance. Nevertheless, the proposal will certainly provide encouragement to the beleaguered leaders and peoples of the former Soviet republics.

The United States' share of the assistance package would amount to \$4.5 billion (approximately 20%). In addition, the President proposed a \$12 billion increase in the United States' contribution to the IMF (a critical element of the overall program). Congressional approval will be required for much of the President's proposal. Election-year political concerns, domestic issues and the ailing economy make Congressional approval uncertain at best. If Congress fails to approve the United States' contribution, the comprehensive aid program will almost certainly fail to achieve its objectives. This would be unfortunate, for the future of democracy and free market economies in the former Soviet Union may well depend on bipartisan support and swift Congressional approval of the President's proposal.

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