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Lessons from Argentina and Brazil

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Executive Summary

As the successor nations of the former Soviet Union move unsteadily towards economic reform, they face major decisions on how to achieve stabilization and move successfully from central planning to a market economy. In some quarters the successor nations are regarded as groping in the dark, without a road map to guide them. But, in fact, there are recent stabilization experiences elsewhere that are very useful to understanding the options and the potential outcomes faced by the former Soviet Union. We draw upon the experiences of two Latin American countries, Argentina and Brazil, as exemplars of what may lie ahead for the former Soviet Union.

In the Latin American examples, heterodox policies were never meant to offer anything but a temporary solution to the problem of economic instability. In this they were mostly successful. But the Argentine and Brazilian experiences show that if such transitory solutions are not accompanied by orthodox monetary and fiscal policies, stabilization cannot be achieved in the long run. The former Soviet Union has most of the same underlying imbalances. Heterodox policies do not provide a cure for the substantial difficulties faced by reformers. The pathology of inflation and huge deficits can only be treated by balancing the budget and reinining in the money supply. But this will likely lead to an even further drop in output and a rise in unemployment in the short run, outcomes that have significant political liabilities. A much needed dose of pure orthodoxy, in the form of tight monetary and fiscal constraints, will not gain acceptance in the Russian environment where the standard of living has fallen so rapidly, and where an entire population has experienced so much deprivation for so long.
The patience required to endure the implications of orthodoxy does not exist in the former Soviet Union.

Another important lesson from the Latin American experience is that shock approaches to stabilization in the former Soviet Union are likely to fail. And even if they succeed, their success will come only with potentially great economic and political costs. Given the shaky status of the successor nations this seems like a high risk prescription; what is called for is a gradualist approach to economic stabilization that builds faith in the government. Achieving stability is further complicated by the lack of well-developed markets in virtually every part of the economy.

Unfortunately, there are many reasons to be pessimistic about the probability of success of stabilization programs in Russia and the other successor states based on the experiences of Argentina and Brazil and on the multitude of problems inherited by the former Soviet Union. Overcoming such obstacles requires time. The stakes are so high in these nations that to threaten their existence at this early stage with shock treatment seems risky; there are no quick fixes. The former Soviet Union and the rest of the world should be in the game for the long haul.
Economic Stabilization in the Former Soviet Union: Lessons from Argentina and Brazil

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Economic Stabilization in the Former Soviet Union: Lessons from Argentina and Brazil

As the successor nations of the former Soviet Union move unsteadily towards economic reform, they first face major decisions on how to achieve stabilization. The road to both stabilization and the creation of a market economy is seen as marked by an unusual number of roadblocks, if only because these nations are trying to move successfully from central planning to a market economy, a feat never accomplished. In some quarters the successor nations are regarded as groping in the dark, without a road map to guide them. But, in fact, there are recent stabilization experiences that are very useful to understanding the options and the potential outcomes faced by the former Soviet Union. This is certainly true of Russia, which is the first of the successor states to attempt serious economic reform. For this purpose, we draw upon the rich experiences of two Latin American countries, Argentina and Brazil, as exemplars of what may lie ahead for the former Soviet Union. What we will show is that heterodox policies, that is, wage, price, and exchange rate controls, did not work in Latin America and are not likely to succeed in the former Soviet Union.

While there are obvious differences between the economic and political profiles of these Latin American countries and the former USSR, these differences pale in comparison to the valuable lessons that their experiences offer. Both of these countries in one way or another faced the same kinds of stabilization problems
that are now confronting the former USSR. The elements of destabilization that exist in the former Soviet Union can be outlined as follows. After perestroika began in 1986, several major economic problems emerged, particularly toward the end of the 1980s. The former Soviet Union experienced a fatal combination of declining aggregate output, high and accelerating rates of inflation, falling productivity of labor, and exacerbated shortages of consumer goods. These problems were compounded by a budget deficit growing by leaps and bounds, a dramatic growth in the money supply as the government responded capriciously to the wage demands of the working class and the inefficiency of enterprises, a burgeoning second economy because of the failures of the state’s legal economy, and an angry population demanding that the fall in its standard of living be stopped. Argentina and Brazil had to face virtually all of these problems.

Economic Destabilization in the Former Soviet Union

The first element of destabilization is rapid inflation. For most of the Soviet period open inflation did not exist. Prices were rigidly controlled by the authorities, and price pressures were therefore expressed in the form of queues and chronic goods shortages. But beginning in the late 1980s, as controls were loosened, open inflation emerged and it has since developed into an extremely serious problem. Inflation, once officially measured as close to zero, rose to double digits by 1989 (10.5 percent), increased dramatically to 53.6 percent in
1990, and likely exceeded triple digits in 1991.¹

There were two key sources of these rapid price increases. The first was the combined effect of a severe fiscal imbalance and an irresponsible monetary policy. As a percentage of gross domestic product (GDP), the budget deficit rose from 2.4 percent in 1985 to 6.2 percent in 1986 to 9.2 percent in 1988 to 17 percent in 1991.² The budget deficit grew because the economic authorities continued the policy of soft budget constraints which subsidized unprofitable state enterprises, heavily subsidized the prices of food and other consumer goods, continued to maintain full employment even as aggregate output declined, and capitulated to wage increases that were far higher than productivity increases.

In the absence of alternative means of financing its deficits, e.g., through domestic capital markets or foreign capital, the government was forced to have the central bank (Gosbank) print money to cover its deficit, which is the most inflationary possible way to finance a deficit.³ The money supply, which had grown by a total of 6.0 percent from 1981-1985, increased by 6.1 percent in 1986, 7.8 percent in 1987, 13.6 percent in 1988, and 19.5 percent in 1989.⁴ In essence, Gosbank handed the Soviet population extra rubles, which chased non-existent goods. For example, the growth in money income exceeded the change in labor productivity by 3.7 percent in 1988, by 10.6 percent in 1989, and by an incredible 17.7 percent in 1990.⁵ There was great pressure on the authorities to continue
increasing the amount of money. In the face of severe shortages, more money was the only way people could get access to scarce goods, either in the illegal second economy or in the legal private sector where prices were extremely high. With the standard of living so much in decline and with a large increase in the number of people living in poverty, the population demanded increases in their wages and pensions which translated into an easy money policy.

The second major inflationary force was the price reforms of April 1991 and January 1992, which decontrolled prices in an effort to establish true market prices. On April 2, 1991, the Gorbachev government introduced a comprehensive price reform that resulted in substantial price increases by removing subsidies on a large number of goods. Consumer goods prices rose by 175 percent and food prices by 240 percent. An even more radical price reform took place on January 2, 1992 as the first step in Boris Yeltsin’s plan to transform Russia into a market economy. All but 10 percent of retail prices and 20 percent of wholesale prices were completely decontrolled. Overall, prices rose 200-400 percent. Taken together, the two price increases, only nine months apart, probably increased the price level by 400-600 percent.

It is important to point out the crucial difference between these two general sources of inflation. The first resulted from the structural problems embedded in the economy and therefore had the potential to produce ongoing inflation. The second source,
The reforms, was a "corrective inflation" intended to establish a basis for market equilibrium and, in principle, represented a one time increase in prices. But this "corrective inflation" will be perpetuated into the future if there are propagation mechanisms such as wage indexation or the continued existence of structural anomalies. In fact, both informal and formal indexation are present in the former Soviet Union, and the price reforms aimed at establishing market equilibrium conditions may perversely create a basis for wage-price spirals that continue into the future. 

The Stabilization Programs of Argentina and Brazil

During the 1970s and 1980s, stabilization became a paramount objective of a number of Latin American countries. The experiences of Argentina and Brazil, both of which have had difficulties associated with the transition from an authoritarian to a democratic political system, are particularly illuminating for several reasons. There are important structural similarities between the former Soviet Union and these Latin American countries, such as persistent budget deficits which have been financed by money creation, extremely high rates of inflation, the existence of formal and informal wage indexation, and complications in the external sector because the countries experienced balance of payments difficulties and exchange rates that rarely approached market equilibrium.

Since the 1970s, both Argentina and Brazil have adopted various stabilization programs in an effort to tame the inflation
problem and to improve their balance of payments position and examining these two areas can help us predict what Russia may experience.

**Inflation**

The principal views on the genesis and cure of Latin American inflation fall into two camps, the monetarist and the neo-structuralist. Monetarists essentially agree with Milton Friedman that "inflation is always and everywhere a monetary phenomenon...produced only by a more rapid increase in the quantity of money than in output." The monetarists, then, hold excess demand responsible for creating inflation in Brazil and Argentina. Neo-structuralists, on the other hand, view the institutional settings and structural idiosyncrasies (e.g., wage indexation) of a country as prime causes of inflation.

According to neo-structuralists, the inflation in Argentina and Brazil was essentially a self-propelling, inertial phenomenon caused by supply shocks and fights for shares of national income by various groups in the society. When discussing how best to bring inflation under control, the monetarists prescribe orthodox fiscal and monetary policies aimed at reducing excess demand, including eliminating government deficits, reducing government intervention in the marketplace, adopting free trade policies, devaluing the domestic currency, and controlling money growth. The neo-structuralists, on the other hand, prescribe "heterodox" incomes policies that consist of wage and price freezes designed to break the spiral of wage and price increases.
In the late 1970s and early 1980s, the military governments in both Argentina and Brazil relied on orthodox measures to deal with the inflation problem, but to no avail. In Brazil, inflation increased from 38.6 percent in 1977 to 110 percent in 1980, and to 235 percent in 1985. Argentina's inflation, measured in terms of the consumer price index, fluctuated between 100 and 672 percent between 1975 and 1985. By 1985, therefore, when it had become apparent that orthodox policies of the preceding decade had failed to contain inflation, newly installed civilian governments in both countries turned away from orthodox prescriptions in favor of heterodox policies. In Brazil, these plans included the Cruzado Plan (1986), the Bresser Plan (1987), the Summer Plan (1989), and the Collor Plan (1990). In Argentina, the two major programs were the Austral Plan (1985) and the Spring Plan (1988).

The essential characteristics of all these plans included comprehensive wage, price, and exchange rate freeze programs, monetary and fiscal reforms, and many involved the introduction of a new currency. The freeze programs were designed to provide the governments with sufficient breathing room to streamline their fiscal and monetary policies, and to reduce inflation without incurring a decline in output and higher unemployment.

In June 1985, as Argentina's inflation reached the four digit range, President Alfonsin introduced the first ever heterodox plan in Latin America, the Austral Plan. The plan imposed wage, price, and exchange rate freezes and introduced a
new currency, the austral, which replaced the peso at the rate of 1:1000. The introduction of the austral was meant to reestablish confidence in the domestic currency and to eliminate inflationary expectations associated with the peso.

The Austral Plan experienced early successes. The inflation rate fell quickly as the economy underwent a surprising recovery at the end of 1985. The rate of increase of the CPI declined from 30 percent in June to 7 percent in July and 2 percent in August. After a decline in the third quarter of 1985, GDP increased by about 14 percent in the fourth quarter and by 10.3 percent in 1986. But the exchange rate and domestic price freezes created serious imbalances. To remedy the resulting overvaluation of the austral, the fixed exchange rate was put aside in March 1986 in favor of a crawling peg exchange rate, and in April the government announced the end of the rigid price freeze and adopted a scheme of more flexible "administered prices." After the freeze was lifted, it became apparent that the plan was failing as monthly inflation rates climbed steadily until by March 1987 the annual inflation rate (in terms of the CPI) reached 106 percent.

A number of factors contributed to the reappearance of inflation. The first was a drastic increase in the relative price of agricultural products; the ratio of agricultural to non-agricultural prices increased from 65.8 in the second quarter of 1985 to 115.6 in the fourth quarter of 1986. A second factor was the deterioration in the Argentinean external account caused
by: (1) a decline in terms of trade by more than 20 percent, largely a result of a fall in the international price of Argentina's main exports, and (2) an overvalued austral as measured by a widening gap between the official and the black market exchange rates. This, in turn, worsened the deficit problem as the government substantially reduced export taxes to encourage greater exports in the face of lower international prices and an overvalued currency. The third factor was increased pressure on prices caused by a substantial increase in wages in June and July. Finally, the government's failure to control its expenditures and the money supply contributed to the failure of the plan. Even in the short periods when the government succeeded in establishing essentially fiscal balance (e.g., the II and III quarters of 1986), the financial markets reflected excessive credit availability in the form of negative interest rates in both regulated and unregulated markets.

In August 1988, as the annual inflation rate passed the 400 percent mark, Argentina introduced another heterodox plan called the Spring Plan. The plan froze prices and devalued the austral by 11 percent. A multiple exchange rate system was introduced with the intention of generating revenues for the government. According to this scheme, the government would sell the austral to exporters at the official exchange rate while it would sell the currency to importers at the considerably higher black market rate. The revenues generated by this process, however, did not solve the budget deficit problem. In February 1989, when the
government devalued the currency substantially, the failure of the Spring Plan became obvious.\textsuperscript{25}

Brazil introduced its own version of heterodox stabilization in February 1986, in the form of the Cruzado Plan, which in many ways resembled the Austral Plan. The Cruzado Plan also imposed a temporary price and wage freeze, and introduced a new monetary unit, the cruzado, which replaced the cruzeiro at the rate of 1:1000. But before the freeze went into effect, the government granted wage increases of 15 percent to those earning a minimum wage, and 8 percent to the rest of the labor force.\textsuperscript{26} This was done for two reasons: first, to address partially the lingering question of inequity in the distribution of income, and second, to allow those groups which had not received wage increases because of the unsynchronized nature of contracts to catch up.

But in its effort to stabilize the economy, the Cruzado Plan inadvertently introduced significant imbalances that later contributed to its failure. While the plan froze prices for an indefinite period of time, inflationary pressure was exerted on two fronts. In the first instance, the rising wages which immediately preceded the freeze led to an increased demand for goods, but fixed prices reduced the availability of goods which in turn led to shortages, hoarding, and an increase in the activity of the underground economy. On the second front, the wage-price squeeze led to considerable financial losses for state enterprises that were covered by government deficit spending. The budget deficit increased by 70.5 percent from September 1986.
until the end of the year, even though prices declined by 41 percent during the same period.\textsuperscript{27}

Because of the popularity of the Cruzado Plan, the government avoided price adjustments until after the November 1986 election. It then launched the Cruzado II Plan which realigned the wide variety of prices and increased taxes for the purpose of dampening aggregate demand. These price rises, however, set in motion an automatic wage adjustment mechanism that would increase wages in response to an annual inflation rate of 20 percent.\textsuperscript{28} Thus, once again, the wage-price spiral was triggered. Unlike the economic conditions that existed prior to the Cruzado Plan, the Brazilian economy now faced significant balance of payments difficulties and a slowing of economic growth.\textsuperscript{29}

A second heterodox plan, the Bresser Plan, was introduced in Brazil in June 1987. It, too, contained price and wage controls that were scheduled to last for three months. While the Cruzado Plan had created immediate imbalances by granting wage increases prior to the freeze, the Bresser Plan did so by devaluing the cruzado the day the freeze took effect and by committing Brazil to a series of needed mini-devaluations that put pressure on prices. The inflationary exchange rate devaluation was adopted because of the balance of payments pressures and a highly overvalued cruzado. Between May and December 1987, the cruzado was devalued by more than 65 percent.\textsuperscript{30} In September, government employees received considerable wage increases further
worsening the fiscal situation. By the end of 1988, when the inflation rate surpassed 1,000 percent, it was clear that the Bresser Plan was no more capable than its predecessor of controlling inflation. Like the Cruzado Plan, the Bresser Plan was unable to control the budget deficit. Once again, a heterodox plan had failed.

A few months later, in 1989, yet another heterodox plan, the so-called Summer Plan, also known as the New Cruzado Plan was introduced. The Summer Plan, like the two previous plans, imposed a price and wage freeze that was designed to last a maximum of two months. It eliminated wage indexation and introduced yet another currency (cruzado novo) that replaced the cruzado at the rate of 1:1000. Thus, in a period of less than three years, the Brazilian currency was devalued by one million percent. The government ambition was to reduce its deficit drastically by closing state enterprises and reducing its labor force by 90,000. But political factors in the form of strong resistance from the national congress and protests by labor, caused the government to modify the plan. Inflation kept climbing, this time approaching hyperinflation.

In March 1990, as the annual inflation rate soared to 37,000 percent, newly elected President Fernando Collor overnight introduced a daring and unprecedented stabilization plan. The Collor Plan contained the usual elements of Brazilian heterodox stabilization programs, such as wage, price and exchange rate freezes and a monetary reform that included the introduction of a
new currency, the **cruzeiro**, which replaced the new **cruzado** at the rate of 1:1. But, in addition, the monetary reform included two other major components: a substantial reduction in the money stock and a moderation in the rate of money growth. The Collor Plan reduced the stock of money (M4) by approximately 80 percent by fundamentally blocking access to all bank accounts for a period of eighteen months, thereby producing a massive liquidity crisis. The monthly growth rate of the money supply (M1) was reduced from 92 percent in February to 36 percent in April and May.\(^{33}\)

The cost in terms of output lost was substantial. According to the National Federation of Industries, in the two weeks following the Collor shock, economic activity declined by 24 percent. The capacity utilization in the consumer goods sector declined from 81 percent in January to 53 percent in April.\(^{34}\)

The Collor Plan’s fiscal goal was to turn a budget deficit/GDP ratio of 8 percent to a surplus of 1 to 2 percent by the end of 1990. To achieve this goal, the government levied new taxes, increased the price of state produced products such as fuel, electricity, telephone and postal services, launched a new privatization program, cut its subsidies to private enterprises, and announced an administrative reform aimed at laying off 360,000 state employees by the end of June. In the process, the government succeeded in turning a deficit of 2,617 billion **cruzeiros** into a surplus of 129 billion **cruzeiros**.\(^{35}\)

Then in July of 1990, the government lifted the price
controls. As repressed prices adjusted upwards towards equilibrium, inflation reappeared. Government efforts to eliminate wage indexation largely failed because labor militancy and strikes increased; in July and August more than three million workers from industries as diverse as autos, transportation, and plastics initiated widespread strikes. In the face of continued pressure from labor, most wages were adjusted for inflation and the wage-price spiral reemerged. In the last quarter of 1990, as the inflation rate mounted, firms increased prices further in response to wage increases and as a hedge against future price freezes. All the maneuvering in 1990 turned into a self-fulfilling prophesy and the Collor Plan II had to be ushered in on January 31, 1991. The heart of the plan was another price freeze and the requirement that wages were to be adjusted only once in February according to the inflation rate of the preceding twelve months. Thereafter, wages were to be determined solely by negotiations between employers and workers every six months. Both workers and employers resisted this new arrangement and, as the inflation rate continued its upward trend, both groups fought for their share of the national pie—to the detriment of economic stability. Another heterodox plan had proven ineffectual.

For both Argentina and Brazil, the year 1990 witnessed an end to experimentation with neo-structuralist heterodox stabilization approaches and a move towards more orthodox policies. In Argentina, the Menem Plan was introduced and in Brazil, President Collor dismissed Zélia Cardoso do Mello, the
economic minister who had authored both failed Collor Plans, and replaced her with Marcilio Moreira who promised to apply orthodox monetary and fiscal policies to Brazil without imposing shock treatment on the economy.

The Balance of Payments

In addition to trying to stabilize prices, Argentina and Brazil also struggled with a deteriorating balance of payments position since the beginning of the debt crisis in 1982. The problem arose when the inflow of foreign capital practically stopped in the aftermath of the Mexican moratorium in August 1982. In order to cope with the resulting imbalance in the capital account, both countries had to achieve significant trade surpluses. Large currency devaluations followed in response to balance of payment problems.

To a significant extent, balance of payments pressures were responsible for fueling inflation. The pressures were largely a result of the huge foreign debt which burdened these two countries because of prohibitive debt service payments. For example, the Brazilian debt interest payment ratio (interest payments divided by the value of total exports) for 1985 through 1987 was 31.3, 31.5, and 31.3 percent, respectively, contributing to an average annual balance of payments deficit of $9.3 billion for this three year period. During the two year period of December 1986-December 1988, the Brazilian currency was devalued by 2,200 percent against the U.S. dollar. For Argentina, the debt interest payment ratio was 49, 49, and 48 percent,
respectively, for the years 1985 through 1987, contributing to an average current account deficit of $2.3 billion for the same period. Both countries responded to balance of payment pressures by substantially improving the trade balance. Brazil turned a trade deficit of $2.8 billion in 1980 into a surplus of $12.5 billion in 1985. During the same period, Argentina turned a trade deficit of $2.5 billion into a surplus of $4.6 billion. But while large devaluations improve the trade balance, they adversely affect domestic prices by raising the price of imports which, in countries with "markup pricing" and indexation, translates into inflation.

An overall evaluation of the stabilization policies attempted in Argentina and Brazil in the last decade offers the following general conclusions. As stabilization policies after 1985 showed, heterodox policies only mask the underlying stresses in an economy and consequently, at best, are successful only in the short run. These policies uniformly failed to remedy the underlying causes of instability. It comes as no surprise that prudent monetary and fiscal policies are crucial to stabilizing the economy, but there are also serious political considerations that impose an array of demands on government and diminish the potential success of monetary and fiscal policies. Indexation in all forms (e.g., wages, savings), the fight over shares of national income in a redemocratizing society, and the lack of faith in the government are perhaps the three most important of such political problems. Finally, external pressures channeled
through balance of payments difficulties can have significant repercussions for the stabilization process.

The Lessons for Stabilization in the Former Soviet Union

The experiences of Argentina and Brazil with the economics of transition and stabilization bear a close resemblance to current problems in the former Soviet Union. Indexation has been a major component of the social safety net demanded by the population as the standard of living has fallen, particularly because of inflation. Even though Russia and Ukraine are to be recipients of outside aid, contingent on dealing with the inflation problem, they continued to promise their people some form of indexation. When the Russian government passed a minimum wage law in April 1992, the legislation promised the development of a mechanism that would ensure that wages would fall no more than 30 percent behind the increase in consumer prices.43 Similarly, in Ukraine, when the Supreme Council of Ukraine established a minimum wage, it authorized the use of May 1992 prices for indexing wages.44 Yet as popular as indexation is, and as tempting as it is for politicians to yield to the demands of a beleaguered population, it is a certain recipe for ensuring the persistence of inflation.

Formalized indexation is not the only source of wage pressure. Workers also use strikes to achieve their wage demands. Since the coal miners strikes of the summer of 1989, there have been many work stoppages that have invariably led to wage increases well above productivity. In 1991, for example,
the coal miners received a hike in wages of 100 percent and railway workers received a 50 percent increase in wages. As more strikes lead to higher wages, they worsen the government’s fiscal position. In such a situation where government choices for financing its deficits are extremely limited, there is a danger of new money creation leading to further inflation.

But workers are not the only source of discontent in the current environment. Soviet industrial managers, used to soft budget constraints, especially in heavy industry and defense, do not want to operate in a market environment. Many of these high level managers are supported by the military who fear a declining commitment to defense spending. The military/industrial complex is an important constituency, but maintaining the privileged position of certain enterprises through continued subsidization is contrary to the interest of stabilization because of its contribution to the budget deficit.

One of the clear ways in which the effort to stabilize the economy can be thwarted is through irresponsible monetary policy and there is evidence that Russian intentions are to increase the money supply at rates that can only accelerate the already serious inflation. In order to solve the problem of the shortage of cash necessary to pay worker salaries and benefits, the architect of the Russian economic reform plan, Yegor Gaidar, ordered the central bank to increase the growth of the money supply by 64 billion rubles in April and May and to double that amount in each of three months of June through August (about 125
billion rubles a month) and then roughly double that rate again starting in September (250 billion rubles). Given current projections of monetary emissions, the money supply in Russia will increase by more than 600 percent in 1992. Similarly, there are very dangerous signs on the fiscal horizon. As of May 1, Russian enterprises had accumulated a 1.43 trillion ruble debt they owed to one another and to banks. To put this number into perspective, it was greater than Russia's gross national product in the first quarter of 1992. Because these enterprises are state owned, the debt is an obligation of the state, already burdened by significant budgetary imbalances.

Dealing with inflation and the budget deficit became a prerequisite for outside economic assistance. The International Monetary Fund (IMF) set conditions in the spring of 1992 which required Russia to cut its budget deficit to zero and its money supply growth to a considerably lower level as part of the aid package. However, although the Russian government planned for a balanced budget in the first quarter of 1992, there was an 84 billion ruble deficit during this period. Not only did this give the IMF reason for pause, it was also evidence that Russia was not yet willing or able to pursue judicious monetary and fiscal policies.

The former Soviet Union has also experienced a severe balance of payments problem for the last three years, beginning in 1989 when imports exceeded exports by $5.4 billion. The primary cause of this difficulty was the fall of world market oil
prices and other raw materials, which together accounted for 40 percent of Soviet hard currency earnings. The deterioration of the terms of trade, combined with the decline in Soviet oil production (from 670 million tons in 1988 to 570 million tons in 1990) significantly damaged the trade balance.\textsuperscript{49} The result was that the foreign trade deficit increased to $10 billion in 1990.\textsuperscript{50} The primary way in which the former Soviet Union covered the imbalance in the current account was to borrow from the west. As a result, the former Soviet Union, which had only a $16 billion foreign debt in 1985, by the end of 1989 had a gross foreign debt of $50.8 billion and by the end of 1991, it was estimated as being between $64 and $90 billion.\textsuperscript{51} Given the fact that the former Soviet Union will have to continue importing a substantial number of goods, especially food, and that prospects for export performance are at best uncertain, trade imbalances and balance of payments pressures are likely to persist.

It is well known that an overvalued exchange rate can lead to a further decline in a nation's balance of payments position. In light of this, the scheduled move to make the ruble a convertible currency is of great importance. In May 1992, it was announced that the ruble would become convertible starting on July 1 and would be allowed to move freely until the end of the month. Originally, it was intended that beginning August 1 the ruble would be allowed to float freely within a band of 7.5 percent on either side of this rate. However, the Russians
decided not to peg the exchange rate until the fall. The range that is selected will be supported by central bank intervention using a $6 billion stabilization fund provided by the IMF.  

Given the fragile economic situation in the former Soviet Union, including its recent bout with galloping inflation, high budget deficits, substantial money supply emissions, and balance of payment difficulties, stabilization seems a highly unlikely outcome, at least in the near future.

Conclusion

In the Latin American examples, heterodox policies were never meant to offer anything but a temporary solution to the problem of economic instability. In this they were mostly successful. But the Argentine and Brazilian experiences show that if such transitory solutions are not accompanied by orthodox monetary and fiscal policies, stabilization cannot be achieved in the long run. The former Soviet Union has most of the same underlying imbalances. Heterodox policies do not provide a cure for the substantial difficulties faced by reformers. The pathology of inflation and huge deficits can only be treated by balancing the budget and reining in the money supply. But this will likely lead to an even further drop in output and a rise in unemployment in the short run, outcomes that have significant political liabilities. A much needed dose of pure orthodoxy, in the form of tight monetary and fiscal constraints, will not gain acceptance in the Russian environment where the standard of living has fallen so rapidly, and where an entire population has
experienced so much deprivation for so long. The patience required to endure the implications of orthodoxy does not exist in the former Soviet Union.

Another important lesson from the Latin American experience is that shock approaches to stabilization in the former Soviet Union are likely to fail. And even if they succeed, their success will come only with potentially great economic and political costs. Given the shaky status of the successor nations this seems like a high risk prescription; what is called for is a gradualist approach to economic stabilization that builds faith in the government. Achieving stability is further complicated by the lack of well-developed markets in virtually every part of the economy.

Unfortunately, there are many reasons to be pessimistic about the probability of success of stabilization programs in Russia and the other successor states based on the experiences of Argentina and Brazil and on the multitude of problems inherited by the former Soviet Union. Overcoming such obstacles requires time. The stakes are so high in these nations that to threaten their existence at this early stage with shock treatment seems risky; there are no quick fixes. The former Soviet Union and the rest of the world should be in the game for the long haul.
Endnotes

1. "The Soviet Economy Stumbles Badly in 1989," Central Intelligence Agency, April 20, 1990, p. 7; Philip Hanson, "Pavlov’s Price Increases," Report on the USSR, March 22, 1991, p. 9. While the official 1991 figure for inflation was 96 percent, virtually everyone else believes it was higher than that. Kommersant estimated that it was between 650 and 700 percent for the year. See FBIS-SOV-91-223, November 19, 1001, p. 36.


3. There was an effort in 1990 to sell bonds in order to fund the deficit, but it was apparently a complete failure. See Izvestiia, March 5, 1992.

4. The Economy of the USSR, p. 49.


8. There were several other sources of inflationary pressure, including: the 1985 anti-alcohol campaign which, while decreasing the amount of liquor available, failed to replace these items with other goods; the Law on the Enterprise which went into effect on January 1, 1988 gave enterprise managers much more freedom to decide prices and many took advantage of their new fund freedom by replacing cheaper items with more expensive items or jacked-up prices when there was little or no qualitative change in an item; the 1986 decrease in imports after oil export revenues fell increased the amount of excess demand; involuntary savings increased a great deal because of the absence of consumer goods; and the unstable political environment created uncertainty about price stability in the future.


19. This was mostly due to the fact that products with seasonal patterns, e.g., agricultural products were not subject to the freeze. Machinea and Fanelli, p. 114.

20. See Table 3.13, p. 143, in Machinea and Fanelli.

21. Ibid., p. 145.

22. Ibid., p. 142.

24. See Table 3.9 in Machinea and Fanelli, p. 135.


30. Calculated from data in Conjuntura Econômica.


34. Ibid. August 1991, p. 327.

35. Nazmi, 1992, p. 28. This is a somewhat deceptive result, since the government reduced its debt service payments from US$10.7 billion (in January and February) to US$0.5 billion in April.


37. Empirical support for this can be found in Peter Montiel, "Empirical Analysis of High-Inflation Episodes in Argentina, Brazil and Israel," IMF Staff Papers, 1989, pp. 527-549.

39. Ibid., p. 100.


42. Dornbusch and de Pablo, 1990, pp. 140-141.


47. Ibid.


