INTRODUCTION

FROM PLAN TO MARKET: THE POST-SOVIET CHALLENGE

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It is hard—very hard—to admit that your life and your work are being senselessly wasted and that you are living in an unnatural, false society, headed with your country for the dead end of history.

—Alexander Tsypko[1]

The Collapse of Communism

As early as 1920, the Austrian economist Ludwig von Mises pointed to the inherent difficulties of communism and predicted that rational economic calculation would be impossible without private ownership of the means of production and money prices.[2] In his great work *Socialism: An Economic and Sociological Analysis* (1922), he presented a devastating critique of socialism as it affected not only economic life but also social order and human freedom.

In his work, Mises demonstrated that without private property, there could be no real competitive markets and no prices to guide rational economic calculation. As such, the centrally planned, socialist economy was bound to fail in its attempt to duplicate the efficiency and wealth creation of a private free-market system. He further showed that in a world of change, an economy devoid of private property rights would result in the politicization of economic decisions; hence, the loss of property implies the loss of freedom.

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[1]Remarks at the Cato Institute's conference "Transition to Freedom: The New Soviet Challenge," Moscow, September 10–14, 1990; in Tsypko (1991, p. 286).

[2]At about the same time Mises (1920) introduced his critique of socialism, two others offered similar critiques: Boris Brutzkus (1921) in Russia and Max Weber (1921) in Germany. For a discussion of Mises, Brutzkus, and Weber, see Hayek ([1935] 1975, pp. 32–35).

Friedrich A. Hayek, following in Mises's footsteps, brought his keen insight to bear on the problem of the use of knowledge under socialism. A fundamental flaw of central planning, according to Hayek (1945), is that unlike competitive markets it offers no way to discover and process localized information. The more rigid prices become, the less useful information they convey.

Hayek also criticized the notion of "market socialism." In his view, incentives and behavior under market socialism would not be materially different from those under central planning; socialism is socialism, and pseudo-competition cannot duplicate the competitive market process (Hayek 1935, chap. 5; Hayek 1940).

Like Mises, Hayek was concerned not only with the effect of socialism on efficiency but also with its effect on freedom. In *The Road to Serfdom*, which was to become one of the most influential books of the century, Hayek explained why under socialism the worst get to the top, and why when there is no private property, there is no freedom.

On property and freedom, Hayek (1944, pp. 103–4) wrote:

> What our generation has forgotten is that the system of private property is the most important guaranty of freedom, not only for those who own property, but scarcely less for those who do not. It is only because the control of the means of production is divided among many people acting independently that nobody has complete power over us, that we as individuals can decide what to do with ourselves. If all the means of production were vested in a single hand, whether it be nominally that of "society" as a whole or that of a dictator, whoever exercises this control has complete power over us.

And on the politicization of life under socialism, Hayek (1944, p. 107) wrote:

> As soon as the state takes upon itself the task of planning the whole economic life, the problem of the due station of the different individuals and groups must indeed inevitably become the central political problem. As the coercive power of the state will alone decide who is to have what, the only power worth having will be a share in the exercise of this directing power. There will be no economic or social questions that would not be political questions in the sense that their solution will depend exclusively on who wields the coercive power, on whose are the views that will prevail on all occasions.

The close link between politics and economics under socialism means that any failure of the economic system (central planning) implies a failure of the political system (communism). Thus, changing the economic system under socialism requires changing the political system as well.

Mikhail Gorbachev recognized this point when he took over as head of the Soviet Communist party in 1985. He was by no means committed to radical economic reform—that is, to the creation of a private free-market system—for he knew such a change would mean the end of communism and his political power. What he wanted was the market *plus* socialism—an irreconcilable position. That is why his policy of perestroika (or economic restructuring) failed. Nevertheless, his policy of glasnost (political openness) helped crack the Communist state and laid the basis for more radical economic reform.

By 1985, the Communist party had already lost its legitimacy; glasnost simply accelerated the process of decay. When Gorbachev opened the Soviet Union to the West, he allowed people to see for themselves the vast gulf between a planned and a free society. This visibility and the increase of freedom encouraged debate, which, in turn, set the stage for an intellectual revolution in the Soviet Union as well as in East Bloc countries.

Liberalization in East and Central Europe

On December 7, 1988, Gorbachev sent a strong signal to those in East and Central Europe who were contemplating radical reform. In a speech to the United Nations, he promised that the Soviets would withdraw their weapons from East Germany, Hungary, and Czechoslovakia by 1991. This decision, plus the expectation that Russian forces would not intervene militarily, gave reformers the confidence to proceed with their plans for liberalization. By 1989, the "market liberal revolution" had begun.[3]

Once the door was open for political and economic liberalization in East and Central Europe, the process spread rapidly. The ossified and artificial structure of the postwar Communist states could not stand the forces of change and the demand for freedom. Some of the key political events that marked the liberalization process during 1989 and 1990 are summarized in Table 1.

The revolution in East and Central Europe reverberated back to the Soviet Union, which itself was an artificial creation and ready to fall.

Death of the Soviet State

The Soviet state faced a mounting economic and political crisis in 1989. Perestroika had not increased economic growth as promised

[3]This term seems appropriate since the radicals wanted to move toward a free society and a market economy.

TABLE 1

LIBERALIZATION IN EAST BLOC COUNTRIES

Date	Political Measures
April 17, 1989	Solidarity gains legal status in Poland.
July 6, 1989	Gorbachev promises not to interfere with liberalization in Hungary and Poland.[a]
September 11, 1989	East Germans allowed to exit through Hungary.
October 6–7, 1989	The Communist party is abolished in Hungary. Gorbachev visits East Germany and urges reform.
October 23, 1989	Hungary declares itself an independent democratic republic.
November 9, 1989	The Berlin Wall opens.
November 29, 1989	Czechoslovakia's parliament abolishes the Communist party's constitutional monopoly on power.
December 1, 1989	East Germany follows suit.
December 13, 1989	Bulgaria does the same.
December 25, 1989	Romania's provisional government is recognized by the United States and the Soviet Union.
January 27–28, 1990	Poland's Communist party dissolves itself and forms a Social Democratic party.
May 27, 1990	The first free elections since World War II are held in Poland.
October 3, 1990	East and West Germany are reunified.
December 9, 1990	Lech Walesa is elected president of Poland.

[a] Gorbachev, no doubt, was influenced by the Tiananmen Square massacre (June 4, 1989).

(there had been virtually no privatization or liberalization), and the Communist party retained its constitutionally guaranteed monopoly on political power. Reformers understood that little progress could be made on economic restructuring until the political regime was changed. The success of the democracy movement in the East encouraged democratic forces in Russia and other republics to push for political reform, and glasnost allowed them to do so.

A major step came in March 1989, with the first multi-candidate parliamentary election since 1917. The Congress of People's Deputies was instituted and, in May, Gorbachev was appointed president of the Soviet Union, although he still retained his title as head of the Communist party. In July 1989, Boris N. Yeltsin, Andrei Sakharov, and other deputies formed the Inter-Regional Group of People's Deputies, which favored radical reform and human rights.

The real political changes, however, began to occur in 1990 with the repeal of the Communist party's monopoly on power and culminated in 1991 with the popular election of Boris Yeltsin, the failed August coup d'etat, the formation of the Commonwealth of Independent States (CIS), the resignation of Gorbachev, and the formal end of the USSR on December 31. Table 2 presents a summary of those and other key political events during the 1990–91 upheaval and death of the Soviet state.

When Stanislav Shushkevich, Boris Yeltsin, and Leonid Kravchuk met on December 8, 1991, to declare the formation of the Commonwealth of Independent States, they concluded:

> The shortsighted policy of the center has led to a deep political and economic crisis, to disintegration of the economy and catastrophic decline of the living conditions of practically all the sectors of the population.[4]

With the collapse of communism and the end of the Soviet state, the leaders of Belarus, Russia, and Ukraine set out to create a new political/constitutional order—one based on individual sovereignty and the rule of law. The leaders were also committed "to carry out coordinated radical economic reforms aimed at creating feasible market mechanisms, transformation of property and ensuring the freedom of entrepreneurship" ("Text of Declarations" 1991). Thus, the path was now clear for the transition from a planned to a market economy.

Transition from Plan to Market

As the Soviet state began to crumble, so did central planning; but private markets were slow to appear. Vested interests blocked attempts to liberalize the economic system and sought to protect their privileges. By the summer of 1990, the Soviet economy was in a precarious situation. Gorbachev and his government, headed by

[4]Cited in "Text of Declarations" (1991).

TABLE 2

DISINTEGRATION OF THE SOVIET UNION

Date	Political Measures
March 15, 1990	Congress of People's Deputies repeals the Communist party's constitutional monopoly on power.
July 2–12, 1990	Boris Yeltsin, Anatoly Sobchak, and Gavriil Popov resign from the Communist party.
June 12, 1991	Yeltsin elected president of Russia by popular vote.
August 19–21, 1991	Hard-liners stage coup d'etat one day before Union treaty is to be signed; coup fails.
September 6, 1991	Soviet parliament transfers power to republics and creates a transitional government; a "Union of Sovereign States" is proposed.
November 25, 1991	Gorbachev and the leaders of seven republics fail to agree on Union treaty.
December 1, 1991	Ukraine declares independence.
December 8, 1991	Byelorussia (Byelarus), Russia, and Ukraine form the Commonwealth of Independent States (CIS).
December 17, 1991	Gorbachev announces his agreement to let the USSR formally end on December 31.
December 22, 1991	Leaders of 11 former Soviet republics meet in Alma-Ata and support the CIS.
December 25, 1991	President Gorbachev resigns.
December 31, 1991	The USSR ceases to exist.

Prime Minister Nikolai Ryzhkov, faced a critical test: to take a rigid, failing socialist economy and transform it into a modern market economy.

When Gorbachev took over as leader of the Communist party, he was well aware of earlier attempts at economic reform—attempts that were doomed to fail because they were implemented within the existing power structure and did nothing to change the ownership structure. Glasnost helped break the ice for political reform, but in

1990 conservative forces were still strong. Gorbachev himself spoke about the benefits of a market system, but what he had in mind for the Soviet Union was a regulated socialist market not a free private market.[5]

As the economic crisis deepened, Gorbachev decided to take a chance and consider thoroughgoing reform. Thus, on July 27, 1990, he met at the Kremlin with his economic adviser and cabinet member Stanislav Shatalin. During that meeting, Shatalin asked Gorbachev: "Is this just another matter of 'improving socialism' or creating a 'controlled market?' Because if it is, I'm a sick man and I don't have time left for such follies" (Remnick 1990a, p. A1).

Shatalin received Gorbachev's assurance that he was serious about radical economic reform. A working group was then formed by a joint decision of Gorbachev and Yeltsin. Shatalin, who headed the group, was instructed to prepare a program for the transition to a free-market system. In August, the working group issued a report, *Transition to the Market* (Shatalin et al. 1990), which was based on the "400-Day Project" that Grigory Yavlinsky had prepared earlier as an adviser to Yeltsin. The Shatalin report came to be known as the "500-Day Plan" or "500-Day Program," since it set out a 500-day timetable for making the transition to a market economy.

The Shatalin 500-Day Program

The report released by the Shatalin group consisted of two parts: Part 1 dealt with "The Concept and Program" and Part 2 consisted of the "Draft of Legal Acts." The entire document ran to about 400 pages. It was an impressive blueprint for the transition process.

The program set forth principles for a "new economic system," proposed an outline for an "Economic Union of Sovereign Republics," and provided a series of measures that would convert the state-directed economy into a market-directed economy in less than two years.

In the introduction to the report, entitled "Man, Freedom, and Market," the Shatalin group presented its market-liberal vision (Shatalin et al. 1990, pp. i–ii):

> The program sets forth the task of taking everything possible from the state and giving it over to the people. . . .
>
> Nobody seeks to impose anything on anybody. Everybody has a right to choose, guided by his own wishes and capabilities, whether

[5]Milton Friedman (1990, p. 5) uses the expression "free private market," and points out that "the words 'free' and 'private' are even more important than the word 'market.' " He advises reformers to make "the widest possible use not of the market but of 'free private markets.' "

> to become an entrepreneur, an employee of the state apparatus or a manager at a stock company, to engage in individual labor, or to become a member of a co-op. The reform grants citizens the right to economic self-determination, setting the rules which will prevent certain people, groups of people, enterprises and regions from infringing upon the economic rights of others while pursuing their own interests. It is freedom of choice which makes the basis for personal freedom of the people, for the realization of the creative potential of a personality. These are not yet rules for the future market economy, which will emerge only in the course of the formation and development of a market-oriented society. The economic thrust of the suggested program is the transition to the market, laying the groundwork for a society based upon new economic principles.

It is important to recognize that the Shatalin report did not envision the creation of a market economy within 500 days. Rather, the goal was to begin creating the institutions necessary for a free socio-economic system and then let the system evolve naturally. Shatalin and his team took a comprehensive approach to the transition problem; they rejected both the gradualist, piecemeal approach and the "Big Bang" approach.

The primary goal of the 500-Day Program was "to achieve economic freedom for people and build an efficient business system on this base" (Shatalin et al. 1990, pt. 1, p. 7). In the view of the framers of the report, the only way to achieve freedom and prosperity was through the adoption of the institutions of a free private market (pt. 1, p. 7):

> Mankind has not managed to create anything more efficient than a market economy. It gives strong incentives to materialize a man's abilities, to activate labor and business, and to expedite greatly the progress of science and technology. Its own self-adjustment and self-regulation gears take care of the best possible coordination of activities of all economic subjects, rational use of labor, material and financial resources, and balance the national economy. Obviously, transition to an economic system based on market relations is the only way to solve the country's most acute problems, to develop natural links between our economy and that of the world, to ensure production growth according to people's needs and thus the economy's social orientation, to eliminate shortages, and to make the achievements of world civilization accessible to our people.

The Shatalin program set out the prerequisites for a market economy in the form of the following eight "principles of the new economic system" (pt. 1, pp. 7–9):

> 1. The maximum freedom for economic subjects (an enterprise or an entrepreneur). . . .

> 2. Full responsibility of an economic subject for the results of the business, based on legal recognition of all kinds of property, including private property. . . .
>
> 3. Competition of producers as a major source of incentives to business activities, improvement in the variety and quality of goods to meet market requirements, cost reduction and price stabilization. . . .
>
> 4. Market [determined] prices. . . .
>
> 5. Market relations should be extended to all spheres that are more efficient than state or other forms of regulations. . . .
>
> 6. The economy of the USSR should be open and consistently integrated into the world economic system. . . .
>
> 7. A major responsibility of state authorities at all levels, primarily at Republican and local ones, is to provide a high standard of social security of the people, which is to be understood, on the one hand, as a guarantee of equal opportunities for all people to earn their own living, and on the other hand, as state support to disabled or socially vulnerable people. . . .
>
> 8. All government bodies relinquish their direct engagement in business (with the exception of some special fields).

Part 1, chapter 3, of the report dealt with the formation of an "Economic Union of Sovereign Republics," which had the broad support of republican leaders. The report set out the rules for a new economic constitution that would result in a loose confederation of sovereign states, in which the central (Union) government would have only a few well-defined powers. A free-trade area would be created, private property rights would be protected, and the taxing and spending powers of the Union government would be strictly limited. Indeed, the Union government would have no power to tax; its revenues would be dependent on republican governments and the people.

The Union government also would lose its power to print money to finance deficits. A Union Reserve System was to be created to supply a common currency and to conduct All-Union monetary policy aimed at achieving price stability during the transition process. The new central banking system was to be patterned after the Federal Reserve System but without the tool of open-market operations (see Shatalin et al. 1990, pt.1, pp. 25, 57–61).

Thus, the Shatalin program would radically alter the existing political, social, and economic structure of the USSR, and thereby radically alter the power structure. As such, the program was a direct threat to the Communist party leadership and to the nomenklatura. That is why Shatalin, Yavlinksy, Petrakov, and other members of the task force sought to move quickly to introduce legislation and to get the transition process under way by October 1, 1990.

The Shatalin report lays out in some detail the various actions to be taken during the first 100 days, the 100th to 250th days, the 250th to 400th days, and the 400th to 500th days (pt. 1, pp. 22–36). There is no need to repeat those details, except to point out that the expectation was that economic stabilization, privatization, marketization, demonopolization, and price liberalization could all be started (but not necessarily completed) within 500 days. The institutional framework would then be set for the "new economic system."

Boris Yeltsin was quick to latch onto the 500-Day Program; he released the Shatalin report on September 3, and the Russian Parliament adopted the program on September 11. Gorbachev accepted the report in principle but still bent an ear to his conservative Prime Minister Ryzhkov, who on September 11 openly criticized the Shatalin 500-Day Program in the Congress of People's Deputies. What Ryzhkov wanted was a "regulated market economy" with a strong role for the center.

The stage was set for intellectual warfare, and it was witnessed at the Cato Institute's conference, "Transition to Freedom: The New Soviet Challenge," held at the Academy of Sciences' Uzkoye Hotel. With a packed conference hall, Moscow City Council Chairman Gavriil Popov, a supporter of the 500-Day Program and a People's Deputy, told his audience, which included leading market liberals from the West, radicals from the various Soviet republics, and conservative hard-liners:

> There have been dramatic changes today [September 11, 1990]. The old forces are threatening the new program. We may have to ask the people to go into the streets. We have just entered the most dramatic period in our process.[6]

Gorbachev had to make a choice: to follow in Yeltsin's footsteps or to waver on his promise to Shatalin and move toward the conservative agenda. On September 13, he decided to go with the Shatalin Plan; he criticized Ryzhkov and presented the 500-Day Program to the Supreme Soviet. But Gorbachev continued to be pressured by the conservative camp, and the war was far from over.

The Supreme Soviet made two critical decisions on September 24: It gave President Gorbachev emergency powers to bring about economic reform, and it delayed adopting the 500-Day Program. The delay of radical reform by the Soviet government came at a time when Russia was already committed to the Shatalin Plan. But without

[6]Cited in Asman (1990).

the full support of the Supreme Soviet, the Russian parliament would have great difficulty implementing the program. Moreover, the West would remain skeptical about the chances for real reform. The Bush administration choose to wait and see, rather than to encourage Russia to go it alone or to encourage Gorbachev to adopt the radical 500-Day Program (Barber 1990, p. 1).[7]

By failing to give moral support to those who favored comprehensive reform, the Bush administration unwittingly aided the Soviet hard-liners who were pressuring Gorbachev to protect his power center by rejecting the radical decentralization of economic and political life that would occur if the Shatalin program were implemented. In the end, Gorbachev reneged on his commitment to Shatalin and decided to promote a compromise plan drafted by economist Abel Aganbegyan.

The Basic Guidelines: A Compromise Program

On October 16, 1990, the Supreme Soviet adopted the compromise program under the label "Basic Guidelines for Stabilization of the Economy and Transition to a Market Economy." The guidelines provided for economic stabilization, privatization, price liberalization, and other measures that were part of the Shatalin Plan.[8] However, unlike the Shatalin Plan, the guidelines took a piecemeal approach to reform, had no timetable, and left the division of economic power between the center and the republics uncertain. As Niskanen (1990, p. 9) stated, "The Gorbachev [compromise] plan does not address the constitutional relations between the republics and the Union government, suggesting only that economic policy would be developed by 'an interrepublican economic committee.' " The conservative lining here was evident.

The gradualist and timid approach taken by the guidelines did little to reassure the Shatalin camp that sound steps were being taken to establish freedom and democracy. Indeed, government spending continued unabated as did the growth of the money supply. Thus, on November 4, 1990, the Shatalin group, in an open letter to the press, criticized both the Union government and the Russian government for failing to curb spending and for endangering society with the specter of hyperinflation. Under such conditions, they argued, the 500-Day Program was doomed to fail (Peel 1990, p. 1).

[7]The Bush administration made no attempt to offer even moral support for the Shatalin Plan, which would have undermined Gorbachev's power. As Lionel Barber of the *Financial Times* noted from Washington in September 1990, "The administration has little stomach for speaking out in favour of the Shatalin plan" (Barber 1990, p. 1).

[8]For a discussion of the guidelines, see Bredenkamp (1991, p. 20).

Gorbachev further undermined his credibility with radical reformers when he selected Gennady Yanayev as his vice president on December 26. Yanayev, a hard-liner, told the Congress of People's Deputies, "I am a Communist to the depths of my soul" (Remnick 1990b, p. A1).

On January 22, 1991, Shatalin published a letter to President Gorbachev in *Komsomolskaya Pravda* calling for him to quit the Communist party and let it collapse. Shatalin told Gorbachev he should abandon the idea of a Union treaty and instead adopt the radical version of the 500-Day Program, which would establish an Economic Union of Sovereign States. A "multi-national, multi-party, multi-class government of people's confidence" should be formed to implement the reform program, wrote Shatalin. He warned that "economic catastrophe is swiftly approaching" and that Gorbachev should "resign immediately" as president if he wished to compromise (Peel 1991, p. 14).

The Grand Bargain

From the fall of 1989 to the beginning of May 1991, the Soviet government had introduced a total of five economic reform programs, none of which were fully implemented. As the economy continued to slide, a sixth plan was introduced: Prime Minister Valentin Pavlov's "Anti-Crisis Plan," which would retain central control over much of industry while gradually introducing a market economy. The Pavlov Plan allowed for some privatization but was modest compared to the Shatalin Plan. Moreover, Pavlov's program was inconsistent with Gorbachev's April 1991 agreement to pursue a policy of economic decentralization. Thus, the Anti-Crisis Plan was unlikely to prevail. For that reason, Gorbachev began to consider alternatives, one of which was a reform-for-aid program—the so-called Grand Bargain—being prepared by Grigory Yavlinsky (Gumbel 1991; Gumbel and Tucker 1991).

Unlike the radical 500-Day Plan, which Yavlinsky had coauthored, his new program linked each stage of the transition process to specific types of Western assistance. He teamed up with advisers from Harvard and MIT to form a "Joint Working Group on Western Cooperation in the Soviet Transformation to Democracy and the Market Economy." This group included Harvard professors Graham Allison, Robert Blackwell, and Jeffrey Sachs, and MIT professor Stanley Fischer (Yavlinsky and Allison were co-chairmen of the group).

On July 19, 1991, Allison and Yavlinsky outlined the working group's transition plan in a paper presented to the Senate Foreign Relations Committee entitled "Window of Opportunity: Transforming the Soviet Union into a Democracy with a Market Economy." The premise of their paper was that "substantial Western cooperation, including financial assistance, is almost certainly a necessary condition for success in transforming the Soviet Union into a market economy" (Allison and Yavlinsky 1991, p. 6). Table 1 of their paper presented the various stages of reform and specified the types of external assistance at each stage. The levels of assistance would fall as the Soviet Union approached a market economy, a process that was expected to take about seven years.

Allison and Yavlinsky's paper did not include any dollar figures for aid, but their reform-for-aid package was estimated to cost anywhere from $15 billion to $30 billion per year for the first three or four years of the program; estimates for the entire seven-year program ranged from $60 billion to as much as $250 billion. Assistance would include technical as well as humanitarian and financial aid. It was hoped that the program could begin in June 1991 and be completed by the end of 1997.

Privatization, price liberalization, and stabilization were central to Yavlinsky's new program, but the reform process was more drawn out than the original 500-Day Program. Moreover, the new program was to be driven by Western aid. The 500-Day Plan, in contrast, had made no presumption that aid was either necessary or sufficient for transforming the Soviet Union into a free and prosperous nation. Thus, the new program turned attention from the East to the West.

In general, the Western industrialized countries were not interested in bargaining with the Soviet Union. Most countries were willing to extend humanitarian support, but few were willing to commit to large-scale financial assistance—at least until they could be sure that the Soviets were serious about reform. Nevertheless, the Group of Seven (G–7) invited Gorbachev to discuss his plans for reform at the London summit meeting in July. Gorbachev was expected to follow Yavlinsky's reform-for-aid strategy but instead presented an updated version of Pavlov's Anti-Crisis Plan, which only reinforced the impression that Gorbachev was still not serious about moving to a private free-market system (Norman et al. 1991, p. 1).

The reform-for-aid strategy was predicated on the continued existence of a Soviet state. When the Soviet Union disintegrated in late 1991, the Grand Bargain died along with the Union. The responsibility for radical reform will now rest with the leaders of the newly independent states. Whether they are successful in making the transition to a viable market system, however, will depend on whether they can remove the remaining obstacles to reform.

Roadblocks to Reform

If the ex-Communist countries of the CIS are to make the transition from plan to market, they will have to remove the barriers that still block the road to freedom and prosperity. Four major obstacles to reform continue to plague the post-Soviet landscape: (1) the rule of special interests, (2) the anti-capitalist mentality, (3) the credibility problem, and (4) the market-socialist syndrome.

Rule of Special Interests

In the absence of a rule of law, the rule of special interests has full play in the post-Soviet system. Communism may be dead, but the nomenklatura is still alive. The ruling elite under communism—managers of state-owned enterprises, directors of state and collective farms, key government bureaucrats, and military commanders—continue to exercise considerable power and have a strong incentive to protect their privileged positions. Thus, the effort to privatize state property in industry, trade, and agriculture has been at a standstill.

The Russian parliament, for example, is strongly influenced by socialists who are opposed to radical economic reform. Those in power know that once state property is abolished, they will lose their control over economic life.

The food crisis is a good illustration of the power of special interests. Small private plots, although only a tiny fraction of total agricultural land, produce the bulk of staples for the Russian family. However, instead of taking the logical step and privatizing agriculture, the Russians have delayed that measure and continue to struggle with food shortages. The roadblock to reform is the power of the agrarian special interest group, namely, the chairmen of state and collective farms who "are so opposed to private competition they have frequently ruined private initiative on their own farms rather than see their influence diminish" ("Half a Russian Loaf" 1990, p. 58).

If former Soviet republics are to end the rule of special interests and move toward a private free-market economy, it will be necessary to depoliticize economic life by establishing a rule of law. Before that can be done, however, there must be a change in the anti-capitalist mentality that has been ingrained in Soviet culture over the past three-quarters of a century under Communist rule.

Anti-Capitalist Mentality

Perhaps the biggest roadblock to developing a private free-market system is the anti-capitalist mentality that still persists in the CIS. After living off the state for their entire lives, most people in the CIS have become conditioned to socialism and fear the risks of capitalism. The "parasitic mentality," as Anatoly Sobchak (1991, p. 199) calls it, cannot be changed overnight. People have to acquire a market mentality and recognize the function of private property, the role of prices and profits, the importance of speculators and entrepreneurs, and the significance of spontaneous order.

If real reform is to occur, the leveling instinct must give way to the profit motive, bounded by competitive market forces and the rule of law. Unless people are allowed to keep the fruits of their labor and reap the rewards (as well as bear the costs) of their decisions over the use of scarce resources, there can be no real private markets to allocate resources and increase human welfare.

As long as envy is allowed to dictate social and economic policy, the post-Soviet Union will be unable to create the private property foundation necessary for a competitive price system. Accordingly, Otto Latsis (1991, p. 267) writes, "Widespread egalitarian notions that regard high earnings as immoral are the biggest obstacle in our way to a market economy."

Democracy, if unconstrained, could turn the post-Soviet Union into a giant welfare state. The precondition for the development of market institutions, it seems, is a widespread acceptance of the fundamental ethical principle that underlies a free-market system, namely, the sanctity of one's property rights. People have to learn the moral—as well as economic—value of respect for private property rights.

When people learn to respect the rights to life, liberty, and property, a spontaneous market order can emerge. The process of coordination will then take place according to the voluntary choices of sovereign individuals rather than through the coercive force of the state bureaucracy. The emphasis should be on whether the market process is free, not on whether the outcome of that process is socially optimal as judged by some political *apparatchik*.

The choice that the new parliaments in the CIS must make is whether to set the framework for freedom by establishing a rule of law and private property or whether to revert to the old ways and engage in "legal plunder" by passing laws that redistribute income and keep inefficient enterprises alive to satisfy special interests.

Real reform will require a psychological revolution that overturns the myths of socialism and that focuses on the reality of capitalism and the benefits of limited government. The task of reformers is to set both a legal and intellectual framework for reform.

Credibility Problem

Another barrier to liberalization is the near universal lack of confidence in government. For years Soviet leaders have initiated reform measures only to reverse them at a later date. Economic reform has been a ragged process at best, and the lack of any *credible* precommitment to private property and free markets has increased uncertainty about the direction of future reform.

If the new governments of the CIS are to lead the way toward a real market economy, they will need to establish their credibility at the start. Stop-and-go measures will serve only to undermine public confidence and bolster opposition to radical reform. What is needed is constitutional change to override the special interests and to counter the parasitic mentality that now govern social and economic life.

Ruling by decree is no substitute for ruling by law under a freely chosen constitution that protects individual rights. Without legitimate constitutional law and an independent judiciary, the ex-Soviet Union will be subject to the discretion of rulers who may or may not support free enterprise. The resulting uncertainty will discourage domestic and foreign investment and slow the pace of reform.

Market-Socialist Syndrome

A common danger facing ex-Communist countries trying to make the transition to a market system is the illusion that it is possible to have a real market economy without establishing private property rights. Gorbachev, for example, continued to think that socialism and the market were compatible—even after the August 1991 coup.

The failure of perestroika is due to the failure to fully embrace a private free-market system. The newly emerging social democrats argue not for free enterprise but for regulated markets. Social democracy and market socialism—not market liberalism—are at the top of the agenda for many so-called reformers. As Larisa Piyasheva (1991, p. 3) writes, "The illness that infects our entire society today is social democratism, brewed on the idea of social reform in the context of a mixed economy and a 'third way.' This, in my view, lies at the root of the inadequacy of all the government and non-government reform programs."

What the CIS leaders should remember is that when the state is used to redistribute income, the very market process that creates that income will be upset. Attempts to "plan the market" by altering market outcomes can only lead to a deterioration of the incentives that drive the competitive market process and reduce the size of the economic pie. Compromising market principles for the sake of "social justice" can only hamper the creation of a free society and undermine the true sense of justice, namely, the protection of private rights (Hayek 1976).

A change of vision from that of market socialism to that of market liberalism requires a growth of confidence in freedom and spontaneous order. The challenge is to cultivate freedom and to recognize that the best guarantor of human dignity and prosperity is equality of freedom, not equality of outcome.

The Challenge of Freedom

Prior to the breakup of the Soviet Union, the head of the anti-Communist bloc in the Ukrainian parliament, Igor Yukhnovsky, declared: "When something is ruled from the center, the optimization of life is impossible" (Greenhouse 1990, p. A10). With the fall of the Soviet state and the collapse of communism, new life has been pumped into the drive for economic liberalization. Whether the liberalization succeeds, however, will depend on breaking the psychological and other barriers that still block the path toward private property and individual freedom.

As long as there is no constitutional reform to safeguard private property, there can be no real economic and personal freedom to establish a true market economy. As Gavriil Popov put it, "We cannot talk of freedom unless we have private property."[9] The challenge is to remove the remaining barriers to freedom by adopting a constitution that will set the basis for a private free-market system and then let the market institutions evolve spontaneously in an atmosphere of liberty.

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