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Author(s): Gary M. Anderson and Peter J. Boettke

Source: *Public Choice*, 1993, Vol. 75, No. 2 (1993), pp. 101-118

Published by: Springer

Stable URL: https://www.jstor.org/stable/30025635



*Public Choice* **75**: 101-118, 1993.


# *Perestroika* and public choice: The economics of autocratic succession in a rent-seeking society*

GARY M. ANDERSON
*Department of Economics, California State University, Northbridge, CA 91330*

PETER J. BOETTKE
*Department of Economics, New York University, New York, NY 10003*

Accepted 2 April 1991

## 1. Introduction

Mikhail Gorbachev has been widely acclaimed in the West for his reform policies of *perestroika* and *glasnost*. Until quite recently, many pundits boldly declared that Gorbachev's USSR was actually embarked on an abandonment of the communist economic system, and would eventually embrace real democracy and a free market (see, for example, Muravchik, 1990: 25). While recent developments have rendered these forecasts obsolete, the Gorbachev round of reforms surely represents an interesting problem in public choice.

For purposes of analysis, we propose to concentrate on the period from Gorbachev's succession as Chairman of the Communist Party of the Soviet Union (CPSU) in 1985 until the end of 1989 (with occasional references to more recent events). This is the period during which both *perestroika* and *glasnost* grew to dominate the political scene in the USSR. Moreover, the first five years of Gorbachev's rule represented the period of purportedly dramatic "liberalization" within the Soviet system. *Perestroika* appeared to be a truly radical series of reforms, a triumph of ideals over rent-seeking.

Our purpose in the present paper is to argue that, upon closer examination, the succession of Gorbachev in general and the *perestroika/glasnost* "reform" program in particular bear a close resemblance to other, earlier Soviet government policy adjustments which followed shifts in the top leadership. Gorbachev's behavior as a "reformer" over the period 1985 to 1989 can be ex-

* An earlier version of this paper was presented at the Public Choice Society Meetings, Tucson, AZ, March 1990, and at the Austrian Economics Colloquium at New York University, September 1990. We would like to thank the participants at our session, and those at the Colloquium, for their comments and criticisms. In addition, Hal Hochman, Israel Kirzner, Mario Rizzo, Charles Rowley, Robert Tollison, Gordon Tullock, and an anonymous referee provided useful comments and criticisms. The usual caveat applies.

plained by reference to the incentives facing the dictator of a socialist state based on the distribution of economic privilege and political patronage. In short, during the period of *perestroika* Chairman (later President) Gorbachev was an autocrat who behaved in a manner consistent with the public choice theory of autocracy, as presented by Gordon Tullock (1987). Gorbachev's period of "reform" was not an extraordinary example of the role of ideology or vision in human affairs, but a more routine episode of rent-seeking in action.

## 2. Property rights to socialist rents

The "centrally planned economy" of the Soviet Union has often been portrayed as an alternative to market exchange. Supposedly, economic activity is strategically controlled from the center, which allocates quotas, provides accounting "prices" to enterprises, and generally directs the course of the economy in fine detail. Private ownership of the means of production has been abolished, and replaced with "social ownership."

This "central planning model" of the USSR began to come under increasing challenge from economists in recent years. The "centrally planned economy" would appear to be "planned" only in the loosest sense, meaning that general output targets are set for the long run, but that day-to-day economic operations allow enterprise managers (in the state sector) a great deal of effective discretion.[1] In other words, managers are told what types of output to produce, but are essentially allowed to determine the quantity, quality, and distribution of that output independently of the central planners. Moreover, the "second economy," in which goods and services are exchanged at free market prices, apparently plays an important role in facilitating the operation of the "planned sector," allowing enterprises in the latter arena to function.

Furthermore, bribery (in various forms) has always been endemic to the system. The state restrictions and "central plans" constitute, in part, state sanctioned *monopolies* which allow individuals in strategic positions to extract monopoly rents (i.e., bribes).[2]

The Soviet Union never "abolished private property" for the simple reason that such a goal is economically meaningless, hence impossible (see Hayek, 1944 and 1988). In economics, ownership rights refer to the locus of effective decision-making about the use of resources (i.e., *de facto* ownership), and may or may not be consistent with legal boundaries of property (*de jure* ownership). This insight is today a standard convention among economists. While the Soviet Union has changed some aspects of the form of ownership rights, effective ownership rights remain allocated to specific individuals – as they must in *any* real-world economy.

The Soviet system, then, is not really a "non-market economy" but rather

a market subject to intense governmental regulation. Market prices play an important role in allocating goods and services in the Soviet-style economy, but the "real" prices are mostly "under-the-table" (in American parlance).[3]

Understanding the property rights to rent flows in the USSR is crucial to understanding economic "reform." Among other things, *perestroika* has represented the redistribution of rents from their former recipients to new holders of monopoly power.

One frequently mentioned aspect of Soviet-style systems is the virtual absence of legal protection for property rights. Less frequently mentioned is the fact that this absence extends to rent flows. The individuals who have been favored by the State with positions of power (and wealth derived from that power) do not have secure property rights in those positions.

Compare this with the typical situation in Western democracies, where patterns of government redistribution of wealth tend to be based on stable long-term contracts between the legislature and particular interest groups. Landes and Posner (1975) argue that the independent judiciary plays an important role in defining and protecting such legislative contracts between the government and interest groups. The Soviet Union lacks such an independent judiciary.

In a representative democracy, the independent judiciary serves to protect wealth transfer contracts between the legislature and interest groups when the legislators retire or otherwise leave office. If, on average, the relevant decision-makers remain in office for a long period, contracts with interest groups – patterns of government taxing and spending, as well as patterns of rent-generating restrictions on markets – will tend to be stable during their tenure in office. The effective tenure in power of decision-makers (i.e., the very large number of bureaucrats and officials who regulate and oversee the economy on a day-to-day basis) in the USSR was fairly stable. In turn, the system of wealth transfer contracts with interest groups has also been fairly stable for many years.

Given the absence of an independent judiciary, formal contracts (e.g., like the judicial enforcement of "congressional intent" in the U.S.) are not available. Instead, informal quasi-contracts form the basis for the distribution of rents. For many decades, the *nomenklatura* were a fixed group of individuals who controlled all important positions in that country.[4] Monopoly rent rights *were* fairly stable, though based on verbal, personal, informal, quasi-contracts.

The long period of stable rights to rent flows in the Soviet economy recently came to an end. Instead, the complex existing network of rent extraction based on political power has undergone a considerable amount of "recontracting." The period of *perestroika* has had important implications at the level of bureaucratic incentives and rewards. Soviet-style socialism remains alive, however, unwell; but the organization chart of the planning apparatus has undergone a considerable amount of "restructuring."

### 3. The rhetoric and reality of perestroika

At the time of Gorbachev's rise to power, the Soviet economy had experienced a prolonged period of decline.[5] Western estimates of GNP in the Soviet Union show a marked decline from 4.7 per cent annual growth rate during the seventh five-year planning period (1961–1965) to only 2.0 per cent during the eleventh five-year planning period that ended in 1985 (Hewett, 1988: 52). Even more drastic figures of decline are represented in a text by two Soviet reform economists, Popov and Shmelev (1989: 41), who conclude that since "the late 1950s the rates of economic growth have fallen constantly and by the middle of the 1980s had dropped to almost zero." It is within this context of economic decline that Gorbachev announced his plans for the radical restructuring of the Soviet economy. The potential gains to the overall economy from "restructuring" were so obvious to outside observers that Gorbachev's "reform" efforts were largely taken at face value.

The program of *perestroika*, however, has been filled with ambiguities and inconsistencies from the start and continues to be plagued by them.[6] Comparative systems analysts have concluded that even assuming minimal problems of implementation, the basic "reforms" are unlikely to have much effect on overall economic performance because they fail to address the fundamental problems in the Soviet economy.[7]

For example, the Law on State Enterprises, which Gorbachev himself (1987: 86) proclaimed to be of "primary importance" to the reform of the economy, was instituted on 1 January 1988.[8] The law was ostensibly designed to grant financial autonomy to enterprises. But according to Articles 9 and 10 of the law, the enterprises were still subject to State control both in their pricing and output policy.[9] In other words, these "firms" remained State controlled. Thus, despite the rhetoric promising enterprise autonomy, the Law on State Enterprises – the centerpiece of *perestroika* – was never intended to substantially change the basis of State central planning (see Ericson, 1988). More recent "reform" decrees and laws have similarly claimed to accomplish much but in reality made little substantial difference.

Price reform has been another area rife with ambiguities. Initially price reform was to come in 1989, then it was to start in 1991 for some products and 1993 for others.[10] For the first five years following Gorbachev's accession to power, basically nothing happened to the Soviet system of rigid price-by-government-decree. Predictably, official announcements regarding imminent price increases (ostensibly designed as a part of a "price reform" package) led to widespread hoarding by consumers, and shortages on store shelves. As of Summer 1990, five years into the "Gorbachev era," there were growing shortages of virtually everything (see Gumbel, 1989 and 1990). According to a state committee that monitors the availability of 1000 products, as of October 1990,

996 of them could not be regularly found for purchase in ordinary shops.[11] Repeatedly, Gorbachev reacted by promising to bring "relief" by way of maintaining State subsidies on the prices of basic products.

Moreover, there has been a persistent gulf between the rhetoric and the reality of "price reform." The various government plans and proposals offered during the first five years of Gorbachev's purportedly "reformist" regime were not even claimed to promote freely fluctuating prices to guide exchange and production throughout the economy, but instead were all purported designs for "better" *administration* of prices. Prices were still assumed to be tightly controlled by central authorities. More recent plans for "price reform" continue to assume that most prices will not be decontrolled for the foreseeable future.[12]

The reforms that were actually introduced before outright political disintegration began in 1990 simply did not represent a radical restructuring of the Soviet system towards liberalization. "*Perestroika*" did represent a form of radical restructuring, but of *patronage*, not of the overall economic system.

The transition from a socialist to a free market economy is fraught with political complexities to be sure, but represents a simple problem conceptually. Improving the long-run performance of the Soviet economy required implementing reforms such as permitting private ownership of productive resources, allowing free market price formation, and eliminating prohibitions against the voluntary transfer of ownership rights. In short, simply *relaxing* controls, and *reducing* the level of state intervention in the economic system could have been expected to reap substantial economic benefits. Potential political opposition (e.g., from "the bureaucracy") aside, there seems little real evidence that Gorbachev accepted the transition from socialism to a free market even as an ultimate goal of reform efforts. Yet Gorbachev is typically regarded by observers as a highly intelligent, educated man, who was rarely been accused of myopia (economic or otherwise). We suggest that this paradox is only apparent, and not real. *Perestroika* did not emerge as a "plan to end planning," but rather represented the "Gorbachev round" of patronage adjustment which has traditionally followed the transition to a new leader in the Soviet Union. "Reform" rhetoric constituted a quasi-ideological packaging for a rather ordinary redistribution of patronage opportunities.

## 4. Perestroika and patronage

Since its inception, the Soviet state has been an autocracy, although not necessarily a dictatorship (i.e., ultimate authority has usually been shared by a small group). However, at times, a single individual has exercised nearly absolute political power (e.g., Stalin). More often, power has been shared by members of

a small clique, in which one member was clearly "first among equals." For a period following the transition from one Chairman of the Communist Party to the next, the new Soviet ruler's power has usually been relatively weak as he consolidated his political position.

The Soviet state has been an exceptionally stable autocracy since its inception. Throughout history, the most common route to autocratic power has been by coup, usually involving the military. Alternatively, some autocrats have succeeded in establishing a dynasty in which their designated successor is their son or daughter; but such monastic dynasties have rarely maintained continuity for more than a few generations. The "third system" avoids many of the problems associated with these other modes of succession, and has proven very stable in the relatively few cases where it has been successfully implemented. One such case is the Soviet state.

A major characteristic of this "third system" is that the present autocrat appoints a kind of voting body which then determines the autocrat's successor after the autocrat's death. In the Soviet system, this "voting body" has been the Politburo. Tullock (1987: 158–159) notes that the highly-stable Soviet system of succession closely resembles another even more successful example: the Roman Catholic Church, which has used a similar system to appoint Popes for nearly a millennium. Like his predecessors before him, Gorbachev rose to the Chairmanship of the CPSU as the result of a Politburo vote.

Gorbachev's brief tenure as Chairman of the CPSU followed the routine historical pattern, up until early 1990. He never reached the position of near-absolute power gained by Stalin, but neither did any of his post-Stalin predecessors.

Although there was a growing opposition movement outside of the Party – most notably, Boris Yeltsen (President of the Russian Republic), Gavriil Popov (Mayor of Moscow), and Anatolii Sobchak (Mayor of Leningrad) – Gorbachev emerged from the 28th Party Congress (in the Summer of 1990) in control of personnel policy within the Party and the government. In the Soviet context, this meant that Gorbachev controlled socialist patronage.

Among Sovietologists, political patronage has long been recognized as a crucial element in the succession process in the USSR (see Smith, 1987: 343). The succession from one leader to another has typically included a substantial shift in bureaucratic appointments, mostly in the upper ranks, although this "patronage shift" has varied from the fairly minor (e.g., under Brezhnev) to the quite major (e.g., under Khrushchev).

However, much of this "patronage" appointment is only possible in the context of significant transactions costs for the new ruler. The Chairman of the CPSU does not actually have constitutional, legal authority to hire and fire very many of the individuals filling the "patronage" positions. This does not mean that the new ruler does not have the effective power to hire and fire large

numbers of bureaucrats, but only that the costs of accomplishing this end may sometimes be significant.

Take, for example, the Khrushchev succession. Khrushchev instituted a wide-ranging series of changes in the planning system, including a shift in power from the Council of Ministers to the Communist Party in most spheres of policy-making, the downgrading of many ministries from All-Union to Republic status, and the regional cartelization effort (the "*sovnarkhoz* reforms"). Sovietologists generally ascribe these changes, at least in part, to political considerations – i.e., rewarding his allies, and penalizing his opponents (e.g., Hewett, 1988: 225; and Smith, 1987: 345).

This previous episode of "reform" illustrates a common phenomenon associated with the redistribution of patronage appointments, which has continued under Gorbachev. In some cases, the easiest way to replace the administrators of Ministry X with the new dictator's patronage choices is to first *abolish* Ministry X and replace it with new organization Y. This "shell game" eliminates the jobs of the previous dictators patronage appointees, and allows the distribution of the *new* jobs as patronage plums.[13]

As early as the fall of 1985, both of the two key central planning bodies, GOSPLAN and GOSSNAB had new, Gorbachev-appointed leaders. The Council of Ministers also had a new chairman, and by December 1985 Gorbachev had replaced about one-third of the men heading the approximately fifty branch ministries. By early 1987 "all leading institutions in the economic hierarchy, and a good portion of the ministries, were headed by new appointees" (Hewett, 1988: 311–312).[14]

Of course, new faces in the old jobs – or new faces in old jobs with new titles – do not in themselves imply significant "reform." On the other hand, this does not imply that the transition has no effect on the functioning of the system in the short run. It takes some time for new administrators to settle in to smoothly functioning quasi-contractual arrangements with other bureaucrats. During the period of transition from the older, stabilized, regime to the new regime in a particular ministry, the bureaucracy in question will have only fairly loose quasi-contractual bonds and, consequently, will have unusually great freedom of action. This period of "experimentation" will probably be short-lived, but during its brief existence might produce impressive-looking policy shifts at the grassroots level (as the bureaucrats maneuver for better rent opportunities). While this is occurring, the appearance of "reform" is possible. But similar periods of superficial reform, which ended up never really amounting to much, have been a recurring pattern in Russian history, and have continued into the Communist era (see Starr, 1989).

The recent "reforms" were essentially limited to various marginal changes in the organization of the Soviet planning bureaucracy, combined with the bumper crop of new, younger faces populating the upper reaches of that

bureaucracy.[15] Both aspects of "reform" would seem to be (patronage) business as usual. Therefore, the tendency among Western observers to portray. Gorbachev as locked in a mortal struggle with "the bureaucrats" over *perestroika* is very misleading.[16] While many bureaucrats might have expected to *lose* from *perestroika*, many others could expect to *gain*. Intellectuals and members of the academic bureaucracy, for example, have benefitted greatly from *glasnost* and represented some of Gorbachev's strongest supporters in the initial phase of perestroika (1985–1989).

Gorbachev's *perestroika* reforms were commonly portrayed as having a net decentralizing bent (cf. Hewett, 1988: 326). Responsibilities – and resulting rents – were to be reassigned. But this "decentralization" did not represent a movement towards *laissez faire*. The basic nature of the economy, a huge nationalized sector combined with a massive system of interlocking State monopolies, remained the same.[17] One of the apparent implications of "restructuring" in the USSR is the prospect of increased central government spending in the future. That is, the proportion of national income controlled and allocated directly by Moscow is expected by some observers to significantly increase (see Hewett, 1988: 315). The changes proposed by Gorbachev in the ministerial system (including the expanded powers to "coordinate relations" to be given GOSPLAN) have been described as amounting "to a recentralization of economic power in a new, supraministerial, level of the hierarchy" (Hewett, 1988: 338).[18]

The "anti-corruption campaign" is another interesting problem which plays an important role in the redistribution of patronage perks in Gorbachev's USSR. Such "campaigns" mask the political reallocation and redistribution of monopoly rents (pecuniary and non-pecuniary) in the Soviet system. Historically, such efforts have often come soon after the accession of a new ruler, and frequently have recurred during the longer tenures of Stalin and Brezhnev. These "campaigns" might be described as "rent purges." Wealth and power are redistributed from the politically disfavored to the politically favored.

But while these periodic "rent purges" are underway, holders of monopoly positions in the economy will tend to "lay low" for a while, waiting for the purge to end. They then go back to business as usual. The problem is that during these periods of caution, the efficiency of the second economy of bribery is significantly reduced – and hence, so is the efficiency of the overall economy, which depends on "under the table trades" for its day-to-day functioning.[19]

One of the most dramatic changes which have taken place in the USSR in recent months has been the apparent transformation of the Communist Party itself, including changes ranging from a claimed relaxation of the rule by the Party over appointments to bureaucratic positions of responsibility (i.e., the *nomenklatura* system), to the actual abandonment of the Party's legal monop-

oly in Soviet politics (Parks, 1990). As interesting as these developments are, they may ultimately result only in a massive reallocation of rents, by way of a restructuring of the system of internal monopolies and positions of political power. These events are yet additional evidence of a massive turnover in bureaucratic personnel and patronage appointments. Simply stated, positions controlling rent flows went on the auction block in the mid-1980s.

## 5. The demographics of the purge-ocracy

In the representative democracies which have been extensively analyzed by public choice economists, government bureaucracies grow fairly slowly over time, and the current holders of positions within the bureaucracy tend to be members of a number of different age-group cohorts. The process of hiring and retiring (assuming that civil servants tend to have great security of tenure, and rarely get fired) is continuous, but gradual. Hence, "the bureaucracy" are never really the same cohort, who were all hired into their positions at about the same time, and who might be expected to remain in office as a coherent group until about the same time.

The situation in the USSR was, and until recently has been, quite different. The Communist Party of the Soviet Union was the organization that closely controlled the appointment of personnel to positions of power and responsibility. While usually one individual (and at times a tiny group) was clearly in the position of dictator, the Party organization hierarchy distributed considerable political power amongst various echelons of officials. For example, the Chairman of the CPSU may have represented the ultimate authority, exercising considerable influence over who became (and remained) the Chairman of the Communist Party of the Moldavian SSR, but the latter exercised some degree of authority over day-to-day bureaucratic appointments and affairs in Moldavia, and so on. Opportunities for patronage appointments on the part of the Chairman of the CPSU were constrained by the *nomenklatura* system, in which the Party established which individual members were "qualified" – often a strictly *political* judgment – for particular potential appointments. The ability of, say, Leonid Brezhnev to replace the existing manager of a large steel plant with a friend-of-a-friend of his brother-in-law was subject to many Party-determined limitations. Consequently, after changes in leadership in Moscow, the turnover in personnel in responsible positions throughout the bureaucracy tended to be fairly limited and marginal. Mostly the existing bureaucracy, and the planning apparatus, remained very stable.

Stalin significantly increased stability within the Soviet bureaucracy. Brzezinski (1956) described Stalin's reign as a "permanent purge." Before, during, and after World War II Stalin killed or imprisoned a very large propor-

tion of the existing Soviet bureaucracy. One of the lesser-acknowledged consequences of this practice was that the average age of members of the Soviet bureaucracy fell drastically, as young underlings assumed their purged seniors' former positions.[20] This "purge effect" was enhanced considerably by the War, during which an additional substantial percentage of the bureaucracy was killed off. In short, the bulk of the massive USSR state bureaucracy came to power at about the same time, and could be expected to retire (or die of natural causes) at about the same time. While the same cohort basically controlled the most important strategic positions in the bureaucracy, the system which resulted could be expected to be extremely stable in its ordinary operations until that bureaucratic cohort began to retire. Gorbachev "inherited" an imminent, massive turnover in this bureaucracy.

Numerous observers attributed the failure of Khrushchev's, Brezhnev's, and Andropov's earlier efforts at "reform" to the hostility of the "entrenched bureaucracy." But unlike these previous autocrats, Gorbachev faced a radically different situation – the bureaucracy was about to undergo a "demographic transition." In other words, *the transactions costs associated with the realignment of rent flows and patronage opportunities were rapidly, and significantly, lowered*. Finally, by the mid-1980s the cohort which had collectively controlled the bureaucracy since Stalin's rule at last began to die, or retire. With them went the structure of informal quasi-contracts which formed the basis of the Soviet power structure.

There is abundant evidence that a massive turnover in Soviet officials occurred under Gorbachev, beside which earlier patronage appointment reallocations pale by comparison. Colton (1986: 114–115) reports that by 1985–86, shortly after the Gorbachev succession, the average age of Politburo members dropped suddenly by six years, and sharp drops in age were recorded in the Party Secretariat and on the Presidium of the Council of Ministers. Further, average dates of birth were already "advancing in all segments of the elite" (ibid.). At the middle levels of the Soviet government establishment, "functionaries have lost their positions in droves" in a series of personnel changes which "measured by the number of offices changing hands, are the most sweeping of the entire post-Stalin period" (*ibid.*: 89).[21]

*Perestroika* represented Gorbachev's exploitation of such an opportunity for redistribution of rent flows, that resulted from this demographic event. As the holders of major positions of power in the economy either died or retired, much of the quasi-contractual basis behind their positions of power (personal agreements, etc.) ended as well. Gorbachev seized the opportunity to reappropriate positions of power from the former holders, and reallocated them as patronage rewards to his supporters.

## 6. Glasnost as a wealth transfer

Naturally enough, the element in Gorbachev's reforms which has attracted the most attention from the Western media has been *glasnost*: the "new openness" and freedom of expression in the *Soviet* media. Although this policy has often been portrayed as the clearest expression of Gorbachev's "liberalism," an important side effect has received less attention. *Glasnost* has represented an effective autocratic political tactic, at least in the short run.

With the "new openness," Gorbachev has effectively "purchased" the support of (many) intellectuals by bribing them with increased freedom of expression. Landes and Posner (1975) noted that the First Amendment to the U.S. Constitution represented, in part, a wealth transfer to publishers and writers. Similarly, by increasing freedom of expression, Gorbachev has devised a wealth transfer to intellectuals which is cheap to produce: the bribe takes the form of *reduced* controls. The key feature of this particular "bribe" is that Gorbachev has retained the reins, by continuing to control the presses and TV cameras![22] *Glasnost*, then, represents a set of political *privileges* granted to intellectuals who Gorbachev wants to reward, not real *freedoms* (because the major media remain a State monopoly). Pro-Gorbachev journalists have been permitted considerable leeway, while the activities of anti-Gorbachev journalists are tightly restricted.[23] In other words, with *glasnost*, Gorbachev offered a bid for the support of the media establishment and (many) professional intellectuals. Moreover, this wealth transfer was accomplished without any significant central government budget outlay.

The recent upsurge in the uncovering of corruption and inefficiency by journalists has been claimed as a major piece of evidence for the significance of *glasnost*. However, this recent trend had several precedents in Soviet history. Every few years since Stalin came to power, the Soviet press has gone on an "anti-corruption" rampage – which usually occurred during the course of a Kremlin power struggle. Andropov, Brezhnev, Khrushchev, and even Stalin led campaigns against "corruption" – a term that usually referred to the ill-gotten gains of their political opponents, and overlooked the similar ill-gotten gains of their supporters.

*Glasnost* was consistently opposed by the KGB, and its head, Chebrikov (subsequently replaced in 1989). This was unsurprising, given that much of the "corruption" revealed in the press was *KGB* "corruption." These "exposes" led to major replacements of personnel at all levels.[24] Allegations of corruption among the MVD, Interior Ministry secret police were also widespread, and also preceded massive replacement of MVD personnel (Hazan, 1990: 154). Thus, *glasnost* in the press functioned, partly but importantly, to facilitate the removal of officials and bureaucrats who had (for whatever reason) fallen from favor with the ruler. "Openness" in the Soviet media allowed Gorbachev

and his allies to defeat and discredit at least some of their opponents in the secret police services (including the powerful KGB), organizations which many Sovietologists have long regarded as possessing "king-making" power in Soviet politics.

Of course, *glasnost* has produced other long term consequences, which were probably completely uninentended. "Openness" represented a low-cost wealth transfer to intellectuals and journalists, from Gorbachev's perspective, but may have contributed to the instability of the Communist regime in the longer term, by depriving the CPSU of effective control over information and the media. Our point is that *glasnost* produced numerous short-run advantages to Gorbachev, which had nothing to do with philosophy or "liberal" values.

## 7. Free to choose, free to tax

The most dramatic evidence of "reform" in Gorbachev's USSR has been the relaxation of controls on private economic activity. Until the recent law on private economic activity, put into effect in May 1987, it was illegal for individuals to engage in most private productive activities, including most services and handicrafts. Since the new law, though, many forms of private economic production are legally permitted. However, the law requires that the private economic activity does not interfere with the State employment of the individual enterpriser. Only students, housewives, members of private workers' immediate families over the age of sixteen and living with their parents, and pensioners can work full time in such businesses. Loosening the restrictions on the private sector has heretofore produced only marginal changes because the private sector in the USSR is so small relative to the overall economy.

Individuals engaged in such activities must first be licensed by local government authorities (*ispol'komy*), and must subsequently pay either an annual income tax or an up-front annual fee (*patent*). The income tax is progressive, and both the tax and the fees are substantial.[25] While the limited legalization of capitalist acts between consenting adults has received much press in the West, Gorbachev's motivations for promoting such "reforms" have received little scrutiny.

Given that many "illegal" private economic activities have long been tacitly permitted by the authorities, it is unclear what difference legalization will make to the average consumer.[26] Lower transactions costs would tend to improve efficiency, but some individuals will become net losers. Naturally, the well-being of those consumers with a relatively low discount rate, and/or having a comparative advantage in queuing for goods, might be temporarily reduced. Also, the former recipients of bribes from "black," or "grey" market businesses would lose income in the short run.

In contrast, from the standpoint of the central government considered as a revenue-maximizing organization, legalization does produce a tangible benefit. Legal economic activity can be made to produce tax revenue.

For purposes of comparison, recall that the Soviet Union went through a somewhat similar period of limited legalization of private trade during the 1920s (see Boettke, 1990: 113–146). This was termed the New Economic Policy (NEP), and has often been portrayed as a temporary reversion to full capitalism by the Bolshevik state. In reality, the NEP only permitted a fairly narrow range of private economic activities to take place in the context of a largely nationalized economy. During the period of the NEP, private enterprises were forced to pay extremely high tax and licensing fees. Although precise figures do not exist, revenues from this source appear to have been very large, and represented a significant proportion of total State revenue.[27] In addition, local administrators "frequently imposed new taxes on the Nepmen or increased old ones without permission from Moscow," as well as overcharging for licenses (Ball, 1987: 35).

In announcing changes in Soviet agriculture at the Twenty-seventh Party Congress, Gorbachev invoked the NEP precedent and claimed that his proposed reforms were similar (Colton, 1986: 96). But Gorbachev's "neo-NEP" is not a freeing of markets, but the very opposite. The private sector in the USSR has long been a "grey market": technically illegal, but tacitly accepted, and essentially tax exempt. Therefore, the legalization of private domestic trade may primarily represent a large tax increase masquerading as "liberalization".[28]

## 8. Conclusion

Gorbachev has "liberalized" government restrictions in some ways, although much of this "reform" activity seems to have been primarily directed towards the reallocation of patronage opportunities, a routine activity for new autocrats throughout history. For the first five years since Gorbachev's succession, the rhetoric about market-oriented reform bore little relationship to reality. Gorbachev made no serious effort to end the domination of the economy by the central government. One of the apparent goals, and successes, of the Gorbachev era was accomplishing the transfer of resources away from the military; a goal shared by Khrushchev in the early 1960s (although with less success). More dramatically, by withdrawing the previous level of massive subsidies to the Eastern Bloc countries, Gorbachev succeeded in ending an entanglement which was a net drain on Moscow's fiscal resources. Otherwise, Gorbachev and *perestroika* closely resembled earlier, and equally marginal, "reform" episodes.

But even if Gorbachev's *perestroika* is based on the redistribution of rents disguised with "liberalization" rhetoric, it now seems obvious that a basic conflict exists between Gorbachev's short-run interests – even if they are maximizing the gains, both pecuniary and in power, from the exercise of political patronage – and the long-run stability of the Communist economic system. Some historians argue that one of the major causes of the Reformation, which limited without destroying the power of the Catholic Church, was the sudden increase in the sale of indulgences by the Papacy, that was maximizing revenue in the short run. The Gorbachev phenomenon represents a similar kind of situation. The Gorbachev *perestroika/glasnost* strategy for reallocating patronage, and securing his personal power, represented a kind of "capital consumption" of the infrastructure of the communist system; the stability of communist domination in the long run was reduced, although Gorbachev consolidated his personal power – and control over rent flows – in the short run.

Considered as a rent-seeking society, the Achilles Heal of the Soviet-style economy has always been the absence of secure property rights to rent flows. The Soviet economy has grown into a complex system of market restrictions and rent opportunities for the politically favored. Those on top were given access to great wealth and tremendous power. But these advantages were inherently insecure, and based on informal agreements with no strong legal protection. Positions of wealth and power were only secure until the next purge – which could come any time, and might well result in literal, as well as figurative, "termination." The Gorbachev succession was a kind of autonomous shock, that drastically reduced the real rates of return to rent-seeking in the Soviet economy. Gorbachev may find himself presiding over the demise of Soviet state socialism as an unintended consequence of his exploitation of opportunities for the reallocation of patronage positions.

## Notes

1. See Lavoie (1986–87), Roberts (1971), Rutland (1985), and Zaleski (1980) for a detailed examination of the reality of "central planning."
2. For a discussion of the inner-workings of rent distribution within the Soviet system see d'Encausse (1980), Simis (1982), Voslensky (1984), and Willis (1985).
3. Selyunin (1988: 15–16) argues that Soviet "planners" also pay close attention to world market prices for resources, which they then proceed to copy. This is a point repeatedly stressed by Ludwig von Mises in his analysis of real existing socialism. See, for example, Mises (1981: 535).
4. See Voslensky (1984) for a discussion of the *nomenklature* system. Also see Winiecki (1990).
5. See the "Novosibirsk Report" by Tatyana Zaslavskaya (1984). Also see Goldman (1983 and 1987).
6. For a history of perestroika see Abalkin (1987), Aganbegyan (1988 and 1989) and Aslund (1989). For a representative sample of the "zigs and zags" of Soviet reform over the past year and a half see the conflicting proposals for "restructuring" offered in Abalkin (1989), Ryzh-

kov (1989 and 1990), Shatalin, et al. (1990) and the Supreme Soviet's "Guidelines for Stabilizing the Economy" (1990), which attempted to merge the Ryzhkov and Shatalin plans.

7. See Gorlin (1986), Desai (1989), Schroeder (1987 and 1989) and Thom (1989) for a discussion of the problems with *perestroika*. Also see Boettke (1991).
8. The complete text of the Law on the State Enterprises was published in *Pravda* (1 July 1987); *The Current Digest of the Soviet Press* 39. 30–31 (1987). Hereafter cited as *CDSP*.
9. As a report in the *Moscow News* stated: "It is as though the directors were being forced to swim with their hands and feet tied." *Moscow News* (10 April 1988) as quoted in Thom (1989: 40).
10. See, for example, *CDSP* 42. 24 (1990: 13–15).
11. See *The Economist* (20 October 1990: 11) for a discussion of these problems.
12. The Ryzhkov government's proposal for 1991, for example, was to change those figures to 60 percent centrally fixed prices and 40 percent unrestricted pricing. The breakdown for the consumer market in 1991 for light industry goods was to be 60 percent fixed prices, 30 percent regulated prices and only 5 to 10 percent unrestricted pricing. For cultural, consumer and household goods those figures were to be 40 percent, 35 percent and 25 percent. See Ryzhkov (1990).
13. Hewett (1988: 310) describes Gorbachev's "reforms" as a form of patronage reallocation.
14. Smith claims that "the record of Mikhail Gorbachev in making personnel changes early in his tenure in office has eclipsed that of any previous leader of the USSR," and adds that by January 1987, only 19 (of fifty-odd) ministers remained at their posts who had been in place at the time of Gorbachev's succession (Smith, 1987: 347).
15. In October 1990, before the onset of recent, even more "conservative" (i.e., traditional communist) policies, the Gorbachev plan for economic reform called for the continuation of the central planning system, central control over basic raw materials, the retention of central direction of prices, and made no commitment to the privatization of land. See *The Economist* (20 October 1990: 61).
16. See Hazan (1990: 221) for an example of such an interpretation.
17. A recent newspaper article (Keller, 1991) describes the case of the Uralmash Machine Tool Works as a kind of microcosm of the interlocking monopolies, and near-total reliance on centralized decision-making, which continues to characterize the industrial structure of the supposedly "reformed" Soviet Union.
18. Hewett interprets the Gorbachev reforms as oriented towards "the future industrial structure as one in which a few thousand large, vertically integrated, national-level enterprises would handle national-level markets, while local and regional markets, as well as some of the needs of these ... would be handled by enterprises founded and operating under republican and national authorities" (1988: 331, fn. 45) – that is, a form of socialism, albeit partially decentralized.
19. The current "anti-corruption campaign" has been portrayed as an example of the economic liberalization under *perestroika*. In fact, instead of increasing effective competition, the clamp-down on bribery and graft has probably made markets *less* competitive in practice. Enterprises which for decades utilized bribery and other black market transactions to overcome the chronic shortages and delays associated with central planning now find that their ability to do "end runs" around the planners is greatly restricted. A number of comparative systems scholars have noted that *bribery* has long played a vital role in keeping the "centrally planned economy" minimally functional. The Gorbachev "anti-corruption campaign" may have seriously impeded the operation of this "safety valve."
20. See Voslensky's discussion of the origin of the ruling class in Soviet Union (1984: 14–67). As he points out, "In 1930, 69 percent of the regional and district secretaries and secretaries of the central committees of the Union's constituent republics had joined the party before the

revolution. In 1939, 80.5 percent had joined the party only after 1924, i.e., after Lenin's death. Of the 1939 secretaries, 91 percent were under forty; in other words, they were adolescents at the time of the revolution. The figures for the secretaries of regions and towns are similar. In 1939, 93.5 percent had joined the party only after 1924, and 92 percent were under forty" (1984: 61). Stalin's purge of the "Old Bolsheviks" served, among other things, to create a layer of very young and loyal apparatchiks.

21. Soon after Gorbachev became Chairman, *Pravda* printed several letters which called for an across-the-board Party purge. In 1985, if such a suggestion appeared in *Pravda*, by definition it had the Chairman's approval. Gorbachev publicly dismissed this suggestion, but stated that the Party was carrying out a non-violent and more selective "cleansing" (*ochishcheniye*), mostly by means of retirements. See Colton (1986: 89).
22. The text of the law on the press and other media was published in *Pravda* (20 June 1990); *CDSP* 42. 25 (1990). Gorbachev (July 1990) had announced that television should function independently of all political and public organizations. At the same time, however, the Gorbachev announcement reaffirmed Moscow's control over television by stating that "all legal acts of republican and local authorities aimed to change the legal and property status of television are invalid." Altogether, this is an excellent example of a "reform" that superficially appears to herald a dramatic shift, but really gives away little or nothing. See *Radio Free Europe/Radio Liberty Daily Report*, No. 133 (16 July 1990: 8). Hereafter cited as *RFE/RL*.
23. There are numerous cases like that of Sergei Kuznetsov, a journalist for *Glasnost* magazine, who annoyed Gorbachev and was first deposited in a psychiatric institution, then sentenced to three years hard labor after being accused of "slandering the Soviet state." See Ledeen (1990: 15). Also relevant is that in Spring 1990, the Soviet government passed a law protecting the President's honor from "slander in the press." See *CDSP* 42. 21 (1990). Recently, Valeriya Novodvorskaya, one of the leaders of the "Democratic Union", was arrested and sentenced to 15 days imprisonment for "defaming the CPSU, the Congress of People's Deputies and the dignity of the President of the USSR." See *RFE/RL*, No. 148 (6 August 1990: 9).
24. For example, *Izvestiya* published an expose of the lavish lifestyle and extensive property of Alexsey Boyko, chief of the Turkmenian KGB, which facilitated Boyko's subsequent dismissal. This episode is typical of the campaign in the press against the KGB, usually followed shortly by reports of the dismissal of the accused officials. In February 1988 alone, the dismissals of the KGB chiefs in five republics (Ukraine, Kazakhstan, Lithuania, Tadzhikistan, and Kirgizia) were announced, and many of their assistants were fired as well (see Hazan, 1990: 153).
25. The marginal tax rates range from 15 percent for incomes up to 3,000 rubles a year, to 65 percent on incomes above 6,000 rubles. The *patenty* fees are set by region, and are also high. For example, in the Russian Republic, the *patent* for a private taxi costs 560 rubles, which implies that the taxi-driver must – during his hours off from his "day" job, when he works for the State – earn the equivalent of at least 3 months wages before he can clear any net revenue from his taxi-driving (Hewett, 1988: 340–341). The perverse consequences of this are described in the Moscow diary of Taubman and Taubman (1989: 46–47).
26. Western estimates of the extent of the Soviet "second economy" pre-Gorbachev ranged from 15 to 30 percent of GNP (Lacquer, 1989: 203, fn. 10); granting *de jure* legality to business which has long had *de facto* legality might not have much net effect on the aggregate level of such activity. Also see Feldbrugge (1989) for a discussion of the underground economy in the Soviet Union.
27. For example, the combined tax burden on private traders and manufacturers in 1924/25 was equal to 53 percent of the private traders' reported profits, and 42 percent of the private manufacturers' (Ball, 1987: 54). These figures do *not* include the various license fees imposed by the central government and by local authorities, which were substantial (ibid.: 29).
28. See Gorbachev (1989) for an outline of the official tax policy in relation to the cooperatives.

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