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## Why Coupon Socialism Never Stood a Chance in Russia: The Political Conditions of Economic Transition

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John Roemer writes that the best chances for the adoption of coupon socialism are to be found in the former Soviet societies.

The countries where the opportunity costs of adopting market socialism are the least are, I believe, those that have formed in Eastern/Central Europe and out of the Soviet Union since 1989. These countries face a momentous task of institution building, no matter what kind of market system they will have, and one could argue that the costs of designing stock market, a bank-centric monitoring system, and constitutions that adequately shelter economic institutions (banks, firms) from state interference would be no greater than the costs of building a capitalist system along Anglo-American lines. Indeed, [Corbett and Mayer] have argued that a monitoring system based on banks would be easier to build in the new republics than one based on decentralized market actors and the takeover process.<sup>1</sup>

Indeed, institutional changes in Russia do suggest a convergence with Roemer's market socialism:

1. The command economy with central allocation of resources has given way to a market economy.
2. There are commodity markets and labor markets.
3. Transactions between firms have largely been monetized and firms compete for profits.
4. All citizens were given coupons (vouchers) to the value of 10,000 roubles which they have used to invest in mutual funds or in the purchase of their own or other state enterprises.

5. The most popular form of privatization has been one in which employees assume 51 per cent ownership of their own enterprise.
6. There is no effective capital market so that firms have to raise capital through loans from banks. The government dissolved the old state banks and encouraged the growth of 'independent' and competing banks. Many are tied to conglomerates and thus can be likened to the Japanese 'main banks', which connect firms in a single industry.
7. The central bank monitors all banks to ensure their fiscal responsibility and has at its disposal wide-ranging sanctions: from levying fines, to increasing the reserve ratio (that banks have to deposit in the Central Bank) to the withdrawal of license.

However, the results of these moves toward coupon socialism are far from Roemer's anticipations. The economy has plunged into a nose dive, output has dropped, investment has fallen, the existing means of production are being run down, budget constraints continue to be soft, and inflation has averaged between 20 per cent and 30 per cent a month. Inequalities have widened with the differential chances to exploit market opportunities.

Why is there a gap between promise and reality? At the level of equality Roemer would argue that the Russians made the mistake of allowing trade in vouchers. In Roemer's scheme vouchers are not convertible. They can only be used for purchasing stocks and all transactions in vouchers are recorded. On death, a person's vouchers revert to the state. At the level of efficiency Roemer might argue, as he does for the curiously analogous situation in Yugoslavia in the 1970s and 1980s, that 'those in control of the state organs, national and republican, [were unwilling] to allow firms autonomy or to encourage competition.'<sup>2</sup> It is not an accident that the interference of political authorities, the political distribution of bank credits, and excessive printing of money to meet government budgetary deficits – in short, the rise of soft budget constraints – coincided with the disintegration of the party state. In Roemer's model of coupon socialism the state is *deus ex machina*, a solution more than a problem. It is an untheorized exogenous variable, called upon in voluntaristic manner to guarantee the political conditions of coupon socialism.

In this short comment I argue that such political conditions of coupon socialism are least likely to be realized in Russia today. I highlight the peculiar institutional foundations of the Russian market economy, both as a legacy of the past and of the dynamics of the transition itself. In brief, the disintegration of the party state strengthened

certain features of the old economic order which subverted the intended effects of price liberalization, of the distribution of coupons, of privatization and of the rise of banks. The Russian state was unable to make these reforms work, which raises the question of what sort of state would be necessary to ensure an efficient market economy in Russia. More broadly we have to ask whether market socialism makes consistent demands on the form of state necessary to its functioning and, if so, what institutional forms might meet such requirements.

### 1 From Disintegration to Reform

Behind Roemer's claim that the chances for market socialism are greatest in former state socialist societies is the assumption, held by many economists and political scientists, that the collapse of the party state meant the collapse of the entire Soviet order, in particular its economy. The task, therefore, was to 'build' new institutions and 'design' a new market economy. This popular view has its origins in Sovietology's understanding of the Soviet Union as a society held together by the Party, so that when the Party disappears society crumbles. Nothing could be further from the truth.

The stereotype of the 'command economy' is one in which a planning center dictates to executing enterprises exactly what they shall produce, when and with what means. The center is the brain of society and when it dies the entire social body dies. This model was probably never operative but certainly in the post-Stalin period the relationship between planners and executors was a bargaining relationship in which firms' monopoly of knowledge allowed them considerable control over their own activities. Still, relations among enterprises were constricted, connected to one another like stations on an assembly line. When the center disintegrated enterprises spontaneously recreated their relations of interdependence.

Effectively, the withdrawal of the party led to the strengthening of monopoly tendencies of enterprises, and even more so of the conglomerates that organized individual industries. The party no longer constrained conglomerates and their member enterprises from exploiting their regional monopolies. Barter relations, which had always existed but under the surveillance of the party, suddenly expanded rapidly to the advantage of those who controlled scarce resources. The disappearance of the party not only affected relations between enterprises but also within the enterprise, where workers

assumed even greater control over production than before. The shortage economy did not disappear with the disintegration of central planning but became even more erratic. This drew managers' energies even more toward garnering supplies rather controlling the shop floor, while uncertainty of inputs made worker autonomy and improvisation even more imperative. At the same time a major instrument of managerial control over the shop floor, namely the party, evaporated. In other words, three features of the old order – monopoly, barter and worker control – all increased at the same time as and because of the disintegration of the party state.

The collapse of the party state and resilience of the Soviet economy were the backdrop for the reforms of the post-Soviet period, signaled by price liberalization in January 1992. Price liberalization was to be followed by stabilization, by control over budget deficits and over inflation. Enterprises would have to face market competition and inefficient ones would have to declare bankruptcy. The weakness of the state and the strength of the network of relations among enterprises subverted those intended consequences.

With the stabilization program in tatters, in the summer of 1992 the Russian government blithely moved ahead with its privatization scheme by distributing 10,000 rouble vouchers to all citizens. State property was effectively given away or auctioned off for token prices. At the same time, the Central Bank started to issue an ever-increasing volume of credits to enterprises at negative interest rates which further fuelled inflation. The failure of reform was seen as a failure of political will, attributed to the divisions between a market oriented executive and the still communist legislature, or to the Stalinist hangovers of the managerial class. In fact, these divisions were not the cause of paralysis but the consequence of the balance of power in the country: a reconstituted economy still dominated by the old apparatchiki and an ever weaker central state. To understand the failure of reform one has to explore further the changes occurring in this second phase of the transition.

## 2 Monetization of the Economy, Inter-enterprise Debt and Disintegration of Conglomerates

Monetization of the economy was one of the most startling changes. Beginning in the second half of 1992 and increasing in 1993, despite inflation rates of 20–30 per cent a month, barter relations between enterprises were replaced by monetary transactions. Enterprises that

had a monopoly or near monopoly of needed goods could charge high prices and require immediate payment; those enterprises which produced goods in lesser demand found themselves in a much weaker position, unable to obtain immediate payment and thus entering into debt with suppliers.

Two consequences followed. First, enterprises became increasingly concerned about whether they could sell their goods, given the inflation and declining real budgets of families and firms. Many enterprises found themselves reducing output, introducing shorter working weeks and even closing down for extended periods. There has been a slow shift from a supply-constrained economy to a demand-constrained economy.

Second, enterprises continued to remain afloat despite indebtedness by borrowing from one another. Inter-enterprise arrears grew astronomically during 1992 and 1993 to the level of between 25 and 40 per cent of the GDP. Cancelling mutual debts in the summer of 1993 led to a fall in such debts to a seventh of their former value. These spontaneous credits were essentially interest-free loans in a time of rampant inflation. As a result enterprises could, first, avoid dealing with banks that were increasingly controlling their finances and, second, confuse attempts at estimating their book value, necessary for privatization. As I shall describe below, in addition to inter-enterprise borrowing, banks became involved in short-term lending to cover shortfalls in working capital. Enterprises were able to avoid bankruptcy even when they were heavily in debt. That is to say, soft budget constraints continued despite a movement from supply-side constraints to demand-side constraints, from a shortage to a surplus economy.

Another consequence of the monetization of the economy was the weakening of conglomerates. Individual enterprises could now sell their produce to whom they wanted at whatever price they could obtain and they could purchase inputs from whomever would supply them. In other words, conglomerates no longer had a monopoly of the distribution, neither of the products of enterprises nor of the supplies necessary for production. The most successful and profitable enterprises within conglomerates, whose resources had been drained off to subsidize less profitable enterprises, declared independence and hived off on their own. In such a case the conglomerate was left with the less lucrative remainder. Alternatively, a conglomerate would strike a preemptive deal with the more successful enterprises and abandon the rest to their own devices.

More generally, conglomerates, whose power was challenged by the disintegration of the old administered economy, reacted by creating

their own banks and, through the dispensation of loans, could continue to control the transactions of enterprises. Behind many of the new banks was the power of the old conglomerates. In order to understand how these banks operated we must turn to a more detailed examination of the changes in the financial system.

### 3 The Rise of Banks and the Rationalization of Soft Budget Constraints

Under the Soviet order, there was an extensive banking system but it was one that passively recorded and expedited transactions that had already been completed in the material distribution of goods and services. The banking system was a massive accounting structure that helped in the formulation of plans and then tracked plan fulfillment on micro and a macro levels. Beginning in 1988 bank reforms shifted from the mono-bank system to one based on five specialized banks. These banks and their branches began to have greater discretion in giving out credits at the same time that planning was being decentralized and money was becoming of greater importance. Enterprises were subject to 'state orders' that in principle gave them some leeway to plot their own future if they could produce above the state requisitions.

Already conglomerates began to develop their own pocket banks into which they could funnel money which they could then use for other ends than the ones intended by central planners. In Russia's struggle against the Soviet Union, beginning in 1989, the Russian government encouraged the specialized banks to pursue a course independent of Russia. In particular, in 1990 legislation dissolved the state banking system. With the exception of the Savings Bank, banks had either to privatize or liquidate themselves. Most of the existing banks found sponsors so that they could continue their commercial activities. At the same time hundreds of new banks were created from scratch with funds from conglomerates. The Central Bank continued as a major source of government credits and as a regulatory body that monitored all banking transactions.

As the economy became monetized so the banks assumed new regulatory role in the economy. All enterprises had to have one and only one bank account and all non-cash transactions underwent a cumbersome transfer process from bank to bank through their correspondent accounts in the Central Bank. The old division and non-convertibility between cash and non-cash operations continued.

Not surprisingly, there are long delays in transactions between enterprises, which often redound to the benefit of banks who use the 'float' to extend their loan portfolios. Whereas banks previously represented clients in the payment and requisitioning of bills, now the responsibility lies with the client – except when they move into the red. In this case banks assume control of the client's finances, paying off their debts in a specified order, with government taxes and utilities being first.

The Central Bank regulates banks through prudential norms of capital adequacy, asset ratios and risk factors but, more importantly, through monitoring the balance of each bank's correspondent accounts. Since virtually all transactions go through the Central Bank, the latter can apprehend and punish banks which engaged in illegal activities or allowed their account to move into the red. The Central Bank can fine a bank, raise its reserve ratio or even close it down by rescinding its license.

In effect, the Central Bank compels banks to operate according to hard budget constraints and banks in their turn try to impose hard budget constraints on their clients. They lend out money to clients they trust who are often the sponsors of the bank itself. Enterprises become shareholders of one or more banks in order to obtain credits from those banks. In these very uncertain conditions insider lending is not only legal but becomes the norm. With inflation at 20–30 per cent a month, long-term loans were three months and were offered at negative interest rates, indexed to the interest rate of the Central Bank. In much of 1992 the Central Bank loans were officially at 80 per cent although many loans were offered at even lower rates. Even at these lower rates banks rarely used their money for long-term investment. As a result, businesses with rapid turnover (trading enterprises) were the only ones who could afford to take short-term, high-interest loans. Insofar as they protected their own profit margins and operated under hard budget constraints banks intensified the development of merchant rather than industrial capital.

Since their day-to-day existence was threatened, enterprises had short time horizons. They most urgently required loans, not so much for investment but for working capital. They could borrow money from one another, they could try to borrow from the banks, but a third road was to appeal directly to the regional government or Central Bank. If an enterprise could make a convincing case that without a loan they would be bankrupt and the local community would suffer, the regional government or the Central Bank found ways of issuing a loan. These credits were in effect distributed on the

basis of political criteria. The regional government, that had installed itself in the old regional party headquarters, acted just like its predecessor, either dictating the distribution of loans to the Central Bank or finding resources from its own budget.

However, banks had to assume responsibility for any government loan given to its clients. For servicing the loan the bank received a mere 3 per cent. At such a rate (spread) not surprisingly banks were often unwilling to assume loans, even on behalf of their best clients, and a special bank (the biggest bank in the region which acted as pocket bank of the government) was used to channel the money to enterprises. Under orders from the regional government, the regional branch of the Central Bank was forced to relax its standards of fiscal liability.

This new economic order dominated by banks is in effect a rationalization of the system of soft budget constraints. The regional government and regional office of the Central Bank work together to guarantee the survival of all enterprises irrespective of their economic prospects. Instead of having to organize the delivery of needed supplies or machinery, the central organs simply distribute credits on the basis of need. In this way the central organs perpetuate the dependence of enterprises on themselves. As the head of the economic planning committee told us: 'Managers are simply not ready for reforms, we will have to keep on supporting them for some time.'

The argument can be extended to the relations between Moscow and the regions. Once economic transactions are monetized and the party state has disintegrated, the only way the central government can maintain control is through the extension of credit which comes at the expense of inflation and escalating budget deficits; in other words, at the expense of stabilization. Democracy, if it did nothing else, precluded dictatorship, and left the state reliant on fiscal levers for exercising control over the regions. From each (enterprise) according to its ability, to each according to its need becomes the recipe for perpetuating soft budget constraints and increasing budget deficits, inflation and a rising real cost of living.

#### 4 Privatization, Trade and Worker Control

The irony is that soft budget constraints continue despite privatization. What form does privatization take? Following experiences in Eastern Europe the Russian government realized that few would be interested in buying even the best of Soviet enterprises. Locally, there

was not the capital and internationally, foreign capital simply could not work in a context so uncertain and so dependent on personal contacts, bribes and racketeers. Foreign investors expected immediate returns and would only be likely to participate in joint ventures for the exploitation of natural resources. Even then, only the most unscrupulous of Western capitalists would risk investment, particularly when opportunities were rife in so many other countries where the rule of law obtained.

In the summer of 1992 the Russian government distributed 10,000 rouble vouchers to each Russian citizen, who could deposit them with a mutual fund or invest them directly in an enterprise. They could also buy and sell these vouchers, although their market value never reached their nominal value. Enterprises prepared their own privatization plans according to one of three models, the most popular of which was to sell 51 per cent of the shares to employees. The system of evaluating enterprises was arbitrary, often equivalent to the voucher-buying power of the employees and their families. In effect, 51 per cent ownership was given to enterprise employees. In this process managers would receive a higher per capita share of ownership than the average employee and the enterprise was effectively handed over to those who had run it before.

However, employees as stock owners could replace their managers and herein lay their power beyond the shop floor. They might rise in rebellion when managers were caught feathering their nest by selling off parts of the enterprise, making side agreements that benefited only themselves. In one case, in Vorkuta, the director of the largest and richest mine was caught distributing Volga cars to his friends in high places; cars that were bought out of the mine's revenues. Workers staged a rebellion, organized a strike and a sit-in underground, seized the managerial offices, threw out the director and installed their own. In the furniture factory, where I worked, falling wages, mismanagement and corruption charges were leveled at the director and his entourage. They were thrown out of office by the labor collective and elections produced a new manager. With the evacuation of the party, no body has emerged to mediate relations between workers and managers in such employee-owned firms.

Managers have been prepared to make concessions to the labor collective, trying to guarantee wages and resisting layoffs, but they have been unwilling to subject themselves to being overseen by the shareholders. Given the short-term strategies of many directors and their immediate assistants, this is not surprising. Rather than use profits to reinvest, managers seek to maximize immediate gains by

consuming their profits and cannibalizing their enterprises. In the industries we studied, managers' main objective was, if at all possible, to sell goods abroad at low prices and use the proceeds to buy foreign consumer goods (or deposit unknown amounts in foreign banks) and distribute these among employees at token prices. Natural resources, oil, coal, wood, were flowing out of the country and Western consumer goods were coming in, from trainers to televisions, from Barbie dolls to fridges, from cigarettes to cars. Indeed, one of the most popular businesses involved the reimportation of Russian manufactured Lada cars, virtually unobtainable locally. Foreign cars were not only more expensive but they also required spare parts unavailable in Russia. Short time horizons have led to rapid disaccumulation in industry, with some managers making windfall gains. In these circumstances workers might have longer time horizons, concerned to maintain enterprises in order to keep their jobs.

Plundering the country's resources has become part of the local currency. The government gives out 'quotas' of oil, wood or coal to local enterprises; that is, the right to export specified amounts of these commodities. Quota in hand the enterprise goes to one of the firms with a license to export which organizes the purchase of the raw material at domestic prices and their export at international prices. The difference is divided between the 'export' firm and the enterprise which was given the 'quota'. Thus, when the local hockey team needed money, the President of the Republic called the head of the economic planning committee and instructed her to obtain a 'credit' from the main bank which would receive a 'quota' in return. The local pharmacies were continually being subsidized with quotas in order to import badly needed medicines. On the other hand, the oil industry complains that the government regulates its exports and at the same time depresses the domestic price so that it is unprofitable to extract.

Russia does have a market economy, enterprises are socially owned and they even compete with one another, *but* that competition is over capturing the proceeds from trade. We are back in an era of mercantilism, in which exchange dominates production and the state orchestrates trade, distributing export quotas, licenses and money credit.

## 5 From an Overpoliticized Model of State Socialism to an Underpoliticized Model of Market Socialism

Roemer's claim that the opportunity costs of transition to market socialism are lowest in the Soviet Union and Eastern Europe rest on an overpoliticized conception of state socialism. It assumes that the disintegration of the party state entails the disintegration of the economy. The opposite is nearer the truth: the withering away of the party state led to the reconstitution of the economy and the emergence of a fragmented, anemic and ineffective liberal democracy, incapable of introducing a market economy with hard budget constraints. There is no market road to a market economy: it requires a strong centralized state that dictates the transition to economic actors.

This raises the question of the political conditions of market socialism, questions Roemer does not theorize. Let us first see how he understands politics under capitalism. He assumes that many of the public bads stem, not from the market, but from the concentration of ownership among a small group of people who wield disproportionate power over the state. These capitalists, therefore, effectively resist policies that, for example, protect the environment at the expense of profits. There is, however, an alternative view of the capitalist state in which big business wields much less influence. In this perspective the capitalist state has to be autonomous from the capitalist class in order to protect capitalism against capitalists. The state seeks the maximal expansion of capitalism to increase its own revenues. If the state is interested in the health of the capitalist system rather than the fate of individual capitalists, then there is no reason to believe that its policies will change substantially with the egalitarian distribution of ownership.

Change would seem a likely eventuality if, and only if, citizens, by virtue of their ownership, could and would direct the state to pursue anticapitalist policies. It assumes a democratic state that can be penetrated by citizens and citizens who would want to preserve the environment at the expense of their immediate income. It would assume a radical democracy; a democracy that was concerned with more than the expanded reproduction of capitalism.

Is such a radical democracy compatible with the imposition of hard budget constraints, a state that can remain impervious to pressures for differential distribution of loans, differential interest rates for sectors? Can one insulate radical democracy as the articulation of needs from the state assigned to implement those needs? Is the Taiwan state successful in dictating the trajectory of investment,

because it is able to insulate itself from democratic pressures, because those pressures are in any case weak?

Roemer can maintain that the easiest transition to market socialism will be in the ex-socialist countries only if he can show: (1) how the disintegrated party state will be replaced by an authoritarian state, necessary to install a market economy with hard budget constraints; and (2) that this authoritarian state will wither away leaving a radical democracy behind. We are left with the old Leninist problematic: how can dictatorship give rise to democracy? Democracy is not simply an end in itself but a necessary means for the viability of market socialism. It, therefore, needs to be *theorized* as such. Moreover, the realization of the economic conditions of market socialism may be trivial compared to the *realization* of its political conditions.

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### Notes

1. John E. Roemer, *A Future for Socialism*, Cambridge, MA: Harvard University Press 1994, pp. 126–7.
2. *Ibid.*, p. 89.

## The Prospects for Democratic Market Socialism in the East

*Thomas E. Weisskopf*

In *A Future for Socialism*, John Roemer cogently develops a model of democratic market socialism designed to overcome the limitations of past models of socialism – actual and theoretical – and to constitute an efficient and equitable alternative to capitalism. Toward the end of his book he suggests that ‘the countries where the opportunity costs of adopting market socialism are the least are . . . those that have formed in Eastern/Central Europe and out of the Soviet Union since 1989’.<sup>1</sup> The perception that the prospects for some form of democratic market socialism are now brightest in the countries of the former ‘second world’ has indeed been widespread among advocates of a ‘third way’ between capitalism and Communist-Party-directed socialism.

Roemer offers some persuasive arguments in support of this perception.<sup>2</sup> With the collapse of the Communist Party (CP) state and the ubiquitous desire to establish a new market-oriented economic system, ‘these countries face a momentous task of institution building, no matter what kind of market system they will have’. Each of the countries is engaged in a process of redistribution of rights to national property on a large scale; indeed in some countries (e.g., Russia and Czechoslovakia) ongoing programs of ‘voucher privatization’ of state enterprises are reminiscent of Roemer’s ‘coupon economy’.<sup>3</sup> In most cases the establishment of a new system of property rights is far from complete and thus potentially open to socialist as well as capitalist arrangements. Moreover, the growing inequalities and insecurities which have accompanied the growth of private enterprise in the new market environment have generated increasing popular antagonism, and this suggests that a political base could be formed in favor of a more socialist form of market economy.

In this paper I argue, to the contrary, that the prospects for developing a viable form of democratic market socialism out of the