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Peter J. Boettke
George Mason University, pboettke@gmu.edu

Rosolino A. Candela
rcandela@masonlive.gmu.edu

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Abstract

This paper explores the economics and politics of the tragic Soviet experiment with socialism. Beginning with the period of "War Communism" between 1917 and 1921, the Soviet government's attempt to implement socialism failed to achieve its stated objectives, namely to create social harmony, eliminate class struggle, and to unleash advanced material production. It attempted to achieve these ends by abolishing private property and market prices in the means of production, eliminating the incentives and information necessary to guide production in an efficient manner. The unintended political and economic results were disastrous, leading to tyranny, famine, and oppression. Failing to achieve its stated objectives, after 1921 the Soviet Communist regime continued to survive only by changing the meaning of socialism. *De jure* socialism in the Soviet Union continued to mean the abolition of private property and market competition of the means of production. However, *de facto*, this meant the monetization of political control over resources, via black market exchange, in a shortage economy, and competition for leadership in the Communist Party to control such resources. As a result, the Soviet political system failed to achieve the ideals of socialism on its own terms, not only because central planning eliminated the institutional conditions necessary to allocate resources productively, but also because central planning created the institutional conditions by which the worst men, those most able and willing to exercise force in a totalitarian environment, got to the top of the political hierarchy.

Introduction

The old saying goes that the road to hell is paved with good intentions. After 100 years since the Bolshevik Revolution, there is no mistake that socialism has been an immense failure everywhere it has been attempted. The consequences in the 20th century of collectivism in the Soviet Union was drastic not only in terms of economic performance, but also for overall human welfare. To say that socialism wrought deprivation and death in the Soviet Union is an understatement. R. J. Rummell (1994) estimates that between 1917 and 1987 the Soviet Union was responsible for 61,911,000 deaths at the hands of the government. Is this because human beings are imperfect, and therefore failed to live up to the ideals of socialism, or did socialism as a doctrine fail to live up to the demands of humanity? To put it another way, did socialism fail because the "wrong people" were in charge, or did socialism fail because it generated the very conditions for the wrong people to become in charge? This question is as timely as ever, not only because of the centennial anniversary of the October Revolution, but also because of the recent resurgence of socialism in Venezuela. As Steve Hanke (2014, n.p.) writes,

> Despite frequent references to the late Hugo Chavez's 'Bolivarian' revolution, the [Nicolas] Maduro playbook is nothing more than a rehashing of Marx and Engels' ten-point plan. This was laid out in the *Communist Manifesto*–a crystal-clear road map of where they wanted to take their adherents. Once you reflect on the Manifesto's ten-point plan, you realize that Maduro (and many other politicians elsewhere) aren't very original.

Among these ten points, socialism included, as its fundamental basis, the abolition of private property and, by implication, money prices, which are vital in both delivering the incentives and indirectly providing the information necessary to allocate scarce resources and generate social harmony among the plans of millions of individuals.

The Soviet experience with socialism was the largest social experiment of the 20th century, influencing both directly and indirectly the rise of other socialist regimes throughout Europe, Africa, and Asia. In this paper, we will explore the economic history of the Soviet Union to understand the institutional arrangements under which the Soviet economy operated.

As we discuss in Section II, both in theory and in practice, socialism in the Soviet Union, as first implemented by Vladimir Lenin between 1917 and 1921, was an *immanent* failure, meaning it failed to live up its own goals as first outlined by Karl Marx and followed by Lenin, namely to abolish scarcity by superabundant material production and thus create social harmony among classes. Just like his predecessors in political economy going back to Adam Smith, Marx shared the goal of delivering the least advantaged of society from poverty. His dispute, however, was not with the *ends* of classical political economy, but with the *means* by which to fulfill such ends, namely the abolition of private property in the means of production. Between 1921 and 1928, Lenin and the Soviet regime abandoned socialism in practice, retreating from its original theoretical outlines, and substituting it with the New Economic Policy for the promise of socialism in the future. However, this future was never realized.

In Section III, we explore how, after 1928, the Soviet government claimed to be upholding the practice of socialism, but only by changing the original meaning of socialism. In reality, what socialism came to mean was the political allocation of monopoly privileges to cronies of the Communist Party and the Soviet Planning Committee, known as *Gosplan*. To quote economist and Sovietologist, G. Warren Nutter (1968), markets without property is a grand illusion. Socialism *de jure* meant the abolition of private property and markets, but only to resurface *de facto* in politics as monopoly rights acquired through the use of personal influence, for the purpose of monetizing these rights in the Soviet black market; this practice became known in the Soviet Union as *blat* (Boettke, 1993, p. 168; Levy, 1990, p. 218).

Section IV discusses Mikhail Gorbachev's attempt to reform the Soviet economy after 1985, similar to Lenin's New Economic Policy. In practice, however, Gorbachev's reforms represented only a reshuffling of patronage appointments within the Soviet political system, not of the overall system itself. Under the guise of reform, Gorbachev only changed the "players" holding political rights to allocate resources in the Soviet economy. By not changing the rules that govern economic activity within the Soviet economic system, the Soviet economy continued to experience shortages, bribery, and corruption as it had before Gorbachev rose to power. Section V concludes.

From Marx to Lenin: The Implementation of Socialism and the New Economic Policy in the Soviet Union

As John Reed (1985) reported in *Ten Days that Shook the World*, at his first appearance before the Bolsheviks after the October Revolution of 1917, Vladimir Lenin took the podium, stared out into the cheering crowd and simply said, "We shall now proceed to construct the Socialist order" (p. 129). Their plan of social construction after the revolution was not a by-product of improvisation. Moreover, it cannot be interpreted as simply an unavoidable consequence of the Russian Civil War between 1919 and 1922 (Boettke, 1990b, pp. 16-21). The notion that the Bolsheviks had begun to collectivize property and devalue the currency through inflation due to the necessities of war is merely an *ex-post* rationalization. For example, the economist Maurice Dobb and the historian E. H. Carr argued that given the necessity for the Bolsheviks to fight the civil war, inflation was used as a forced tax on the moneyed bourgeois class. Once money became worthless, it became necessary to abolish private property by confiscating resources by force for the war effort.

This ex-post rationalization is fundamentally flawed in two respects. First, even though the civil war influenced the way that policies were implemented, the war itself had little or nothing to do with what *fundamentally* motivated the policies. The socialist project would have failed even if no civil war took place, precisely because socialism as it was understood was inconsistent with the goals of delivering a post-scarcity world of advanced material production, namely by eliminating the wastes of capitalism. Secondly, Lenin and the Bolsheviks possessed a concrete ideological intention of constructing a socialist order along Marxist lines *prior* to the outbreak of the Civil War. The period now known to economists and historians as "War Communism" (but at the time simply known as Communism), refers to a series of policies which constituted the economic program of the Bolsheviks from 1917 to 1921 (although for purposes of exposition it is perhaps more accurate to place the beginning of this program as December 1917 or January 1918, when the Supreme Economic Council was formed and the nationalization of industry began). As indicated in Table 1, the deliberate march towards socialism had already been outlined and begun to be implemented before the beginning of War Communism.

Table 1: *Major Economic Decrees and Resolutions Passed by the Bolsheviks during the Period of War Communism*

Dates (Western calendar)	Decrees and resolutions
8 November 1917	The Council of People's Commissars is formed
8 November 1917	Decree on Land abolished the landlords' right of property and called for the confiscation of landed estates
27 November 1917	Decree on Workers' Control over Production
15 December 1917	Supreme Economic Council is established
27 December 1917	Declaration of the Nationalization of Banks
15 January 1918	Dividend and interest payments and all dealings in stocks and bonds are declared illegal
16 January 1918	Declaration of the Rights of the Working and Exploited People abolished the exploitation of man by man
10 February 1918	Repudiation of all foreign debt
22 April 1918	Nationalization of foreign trade
1 May 1918	Abolition of inheritance
9 May 1918	Decree giving the Food Commissariat extraordinary powers to combat village bourgeoisie who were concealing and speculating on grain reserves
9 June 1918	Labor mobilization for the Red Army
28 June 1918	Nationalization of large-scale industry and railway transportation
2 November 1918	Decree on the Extraordinary Revolutionary Tax to support the Red Army and the International Socialist Revolution

22 March 1919	The Party Programme of the Eighth Party Congress; called for increased centralization of economic administration
29 March to 4 April 1920	The Outstanding Resolution on Economic Reconstruction is passed, calling for increased centralization of economic administration to insure the unity of the plan necessary for the economic reconstruction after the civil war and foreign intervention
29 November 1920	Decree of the Supreme Economic Council on the nationalization of small industrial enterprises; all enterprises with mechanical power who employed five or more workers, and all enterprises without mechanical power who employed ten or more workers, were nationalized
March 1921	The Kronstadt Rebellion
8–16 March 1921	Resolution on Party Unity abolishing factionalism within the Party is accepted
23 March 1921	The Tax in Kind is established and the New Economic Policy is introduced

Source: Boettke, 1990a, p. 122.

The socialist utopia that Lenin wished to construct was based on works of Karl Marx and Friedrich Engels, who argued that the market economy–based on private property, money prices, and production for exchange–was not only unjust, but also wasteful. The original Marxian paradigm saw rivalry, or what Don Lavoie (1985a) refers to as "the clash of human purposes" (p. 22), as an inherent aspect of the market economy and the price system. For having this rivalrous attribute, Marx condemned capitalism as being anti-social and alienating to the proletariat, since he regarded all of the surplus value of commodity production to be derived solely from labor. Moreover, Marx's critique of the market economy is that the antagonistic mode of capitalist production, based on market exchange, was an unnecessary waste because all of social production was not rationally planned in advance. From a Marxian perspective, capitalism expresses an internal contradiction between, on the one hand, the widening and deepening interdependence of producers upon one another and, on the other, their antagonistic struggle in the market. Because capitalism involves the simultaneous pursuit of conflicting plans by separate, "alienated" producers, he wished to eliminate alienation and the wasteful circulation of goods and services between consumers and producers through buying and selling. Instead, Marx wished to eliminate such commodity production for market exchange and pursue commodity production for direct use under a single, deliberate, and unified plan, as if all production in the economy was organized like one immense factory. Marx viewed central planning as a way of facilitating social harmony and eliminating class struggle by pre-coordinating productive plans in society.

Although Marx said little directly about the nature of socialism, in *Das Kapital* he described its fundamental attributes by clarifying its antithesis–capitalism. To put it another way, "where *Das Kapital* offers us a theoretical 'photograph' of capitalism, its 'negative' informs us about Marx's view of socialism" (Lavoie, 1985a, p. 30). Implicit to Marx's view of socialism was the abolition of the institutional prerequisites of rivalry in the market economy, namely private property in the means of production and money prices. In other words, the abolition of private property, the negation of capitalism, would abolish rivalry and therefore exploitation of the proletariat with it (see Marx & Engels, 1988, p. 198). It was this Marxian vision that Lenin wished to construct, with the Bolsheviks leading the way.

However, in an article titled "Economic calculation in the Socialist Commonwealth," Ludwig von Mises (1975) argued why this project was predestined to fail. Given the stated ends of the socialists, namely to deliver advanced material production, to eliminate the wastes and alienation characteristic of capitalism, and create social harmony, Mises argued that abolishing private property and money prices as a means to achieve this end would make economic calculation impossible. "Where there is no free market," Mises argued, "there is no pricing mechanism; without a pricing mechanism, there is no economic calculation" (1975, p. 111). To put it differently:

1. Without private property in the means of production, there will be no market for the means of production.

2. Without a market for a means of production, there will be no monetary prices established for the means of production.

3. Without monetary prices, reflecting the relative scarcity of capital goods, economic decision-makers will be unable to rationally calculate the alternative use of capital goods (Boettke, 1998, p. 134).

His argument was not a normative assessment of the goals of the socialists. Rather, his indictment of the socialist project was a positive analysis of the means they wished to use to achieve their goals. In the world in which we live, economic decision-makers are confronted with an array of technologically feasible production projects. What economic calculation provides is a means to select from among an array of technologically feasible projects those that employ resources in an *economic* manner, meaning that they are employed according to consumers' most highly-valued uses. Moreover, in order to illustrate the crucial point of his argument, Mises granted as assumptions the best-case scenario in which the socialists are regarded as completely benevolent and possessing all the available technological knowledge about different production processes. Even in this best-case scenario, central planners would still would not know how to *economically* allocate resources, precisely because the economic knowledge required to make this decision is *contextual*: it is knowledge that is embodied *only* in an institutional context of private property rights. That is, *it is only through the act of exchange that the relative and subjective valuation of scarce resources are translated into economic knowledge*. Whereas on the one hand, central planners are precluded from access to such contextual knowledge, as Mises (1975) states clearly, "[t]he property owner on the other hand himself bears responsibility, as he himself must primarily feel the loss arising from unwisely conducted business. It is precisely in this that there is a characteristic difference between liberal and socialist production"[1] (p. 122).

The utopian aspiration under socialist production, however, resulted in a nightmare by early spring of 1921. In all areas economic output fell far below pre-war levels. In 1921 the Soviet Union, as Stephen Cohen (1980) has pointed out, lay "in ruins, its national income one-third of the 1913 level, industrial production a fifth (output in some branches being virtually zero), its transportation system shattered, and agricultural production so meager that a majority of the population barely subsisted and millions of others failed even that" (p. 123)[2]. Never thereafter did the Soviet Union attempt to implement socialism in its purest form.

The Bolsheviks were forced to retreat from their attempt to implement Marx's utopia and instead re-introduced market relations of exchange and production with

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[1] Although Mises had directed his theoretical critique of central planning at actual attempts at "war planning" in Austria and Germany and "war communism" in Russia, his argument applies no less to a mixed economy, which attempts to combine the market mechanism, based on private ownership, with non-comprehensive planning in the production and allocation of resources. Moreover, the actual practice of socialism in the Soviet economy was "mixed" if we include the use of black markets and world market prices to allocate resources alongside central planning. However, government officials by definition did not legally own the capital value of the resources over which they are responsible, even though they had *de facto* control over their use. More specifically, whether bureaucrats direct the allocation of resources through direct ownership, taxation, regulation, or government lending, under a "mixed" economy, they do not directly bear the costs and benefits of their decision-making in terms of owning the appreciation or depreciation of the capital value of such resources in alternative uses *at the time of their decision* (Alchian, 1965, p. 822; see also Rothbard, 1962, pp. 828-829 and Boettke & Coyne, 2004). Costs for the decision-maker only have economic significance at the moment of choice (see Buchanan 1969/1999). This contextual knowledge simply does not exist outside the context of exchangeable private property, whether planning is comprehensive or non-comprehensive. For "the knowledge problem" under non-comprehensive planning, see Lavoie (1985b, pp. 52-57).

[2] Similarly, economic historian Alec Nove gives similar estimates of the tragic consequences of War Communism. See Nove's *An Economic History of the U.S.S.R.* (1969/1984, p. 68).

the New Economic Policy (NEP) in the spring of 1921. This "mixed system" produced varying results over its lifetime (1921-1927), with the high-water mark of economic recovery coming in 1925. The relative freedom of exchange and production produced a drastic recovery from the catastrophe of war communism, particularly through the entrepreneurial activity of middlemen, known as Nepmen. These entrepreneurial middlemen acted on discrepancies in prices between state-owned trusts and private cooperatives to exploit opportunities for profit, generating a more efficient allocation of resources.

However, the NEP did not dismantle the institutional infrastructure within which production took place. Thus, the NEP that was implemented with incentive incompatibilities, failing both economically and politically. For example, the cornerstone of the NEP was the substitution of the tax in kind for the grain requisitioning of "War Communism." Peasants, though, with the war communism period still fresh in their memories had to be convinced that arbitrary requisitioning was not a policy option. The ideological commitment of the leading figures of the Communist Party, not only Lenin, but also Nikolai Bukharin and Leon Trotsky, prevented them from fully adopting the institutional prerequisites of a market economy under the rule of law. Thus, without the government making a credible commitment to maintain the NEP, peasants could not feel secure in their possession of their grain. As a result, by the end of the 1920s (i.e., 1928) peasants no longer had an incentive to market grain surplus. While industrial production was reorganized such that by 1923, of the 165,781 enterprises accounted for in an industrial census 88.5% were owned by private persons, 8.5% were state owned, and 3.1% were cooperative enterprises. Although these private enterprises amounted to 88.5% of the total enterprises, they employed only 12.4% of the total number of workers employed in industry, while the state-owned enterprises, which comprised only 8.5% of the total enterprises, employed 84.1% of employed workers. Thus the state was freed from administrating small enterprises, while at the same time holding fast to the industrial base of Russian society. The "commanding heights" of industry remained state property. The NEP saw a great recovery from the cataclysm of the communist experiment with economic planning, but the system itself was a massive interventionist system possessing its own dynamic (Boettke, 1990b, p. 116).

Moreover, the NEP did not result in any political liberalization. The adoption of NEP was an admission that the task of centrally planning an economy was beyond the ability of the Bolsheviks. But, by moving to market methods of economic organization, Lenin inadvertently threatened the political survival of the Communist Party. So at the same time that Lenin re-introduced market mechanisms he outlawed all political factions within Soviet politics, including factions within the Party. Thus the political monopoly of the Bolsheviks was maintained and solidified. That was the political system that Stalin inherited and manipulated in his struggle for succession after Lenin's death in 1924 and his subsequent consolidation of power in the late 1920s. With Stalin in power, the NEP was abandoned in 1928. The NEP failed not because of the partial liberalization of the Soviet economy. Rather, the internal contradictions of the NEP led to an ever-increasing bias towards political intervention into the marketplace. Since no credible commitment could be made towards market or political liberalization, the only logical alternative for the Communist Party was to reassert authoritarian control over the economy.

The failure of the experiment with pure socialism, the subsequent failure of the NEP, and the rise of totalitarian rule under Stalin, cannot be explained by having malevolent individuals in charge of planning the economy. As Mises argued above, the institutional conditions of socialism precluded central planners from achieving their objectives even under the best of intentions. However, what must also be understood is that the rise of totalitarianism like Stalin is a *consequence* of socialism, not its cause (see Hayek, 1944).[3]

The rationale behind this tragic consequence can be understood by Adam Smith's notion that the division of labor is limited by the extent of the market. In the marketplace, as the extent of voluntary exchange increases, individuals are encouraged to exercise specialization in production to a greater degree in order to increase to their ability to buy goods and services for consumption. In an environment such as the Soviet Union, as resources became increasingly allocated by central planning, the extent of the market must contract at its expense. In the context of central planning, the type of specialization that emerges differs radically from markets. As the extent of central planning increases, the incentive structure within this political context will select leaders who are willing and able to specialize in the use of force over other men. To put it metaphorically, "success" in this institutional context is judged by the ability to treat people like pawns on a chessboard, treating them as a mere means to serve the "common good." The complexity of centrally planning an economic system implies that that planners must be granted almost unlimited discretion in order to respond to its unintended consequences. As a consequence, we should expect that only those that have a comparative advantage in exercising discretionary power will survive. Totalitarianism is neither a consequence of "corruption" nor "historical accident," but rather a logical consequence of the institutional incentives of the attempt to centrally plan an economy (Boettke, 1995).

The Institutional Nature of the Soviet System

Having retreated from the Marxist utopia of socialism after 1921, the textbook model of socialism, namely abolition of private property in the means of production, no longer applied to understanding how the Soviet economic and political system operated. Although the Soviet Politburo continued to invoke the abolition of the injustice of market competition through central planning as its legitimating rhetoric, Soviet-style socialism in reality was best understood as a monopolistic, rent-seeking society (Anderson & Boettke, 1997), one in which property rights over resources

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[3] On a related note, it is important to recognize that a communist political regime will continue to significantly impact a society even after its fall. Negoita (2011) addresses this issue in the context of Romania in recent decades.

were acquired through political competition, rather than untrammeled market competition (Kasper, Streit, & Boettke, 2012, p. 44; see also Tullock, 1967).

Why is this an effective model to understand the Soviet economy? First, given the Soviet economy's inefficiency in terms of delivering economic prosperity to the masses of the population, it explains the political logic by which the Soviet system was able to last so long. This logic was to concentrate benefits on those in power and disperse costs on the masses of impoverished Soviet citizens. As a result, the Soviet system incentivized the creation of a loyal bureaucracy, who benefited directly from maintaining the existing system.[4]

Secondly, since rent-seeking is simply the non-market manifestation of competition for income, derived from political control rights over resources, this model seems uniquely well-suited to analyzing resource allocation in non-market settings, such as in politics. Rather than abolishing private property and rivalrous competition of the marketplace in the name of justice, in reality property rights and competition were simply transferred to the political marketplace of patronage, known as the *nomenklatura* system. The *nomenklatura* refers to a vast political cartel of interlocked state monopolies, which worked to provide and protect perquisites to those in appointed positions of power, namely by controlling entry and competition to these positions. In effect, the *nomenklatura* enforced a collusion among the separate state-owned firms and ministries so that the Soviet system operated as an effective political and economic monopoly. Illicit entry and competition by one monopolist into the privileged market domain of another state-sanctioned monopolist was controlled so as not to chisel the value of the latter's monopoly privilege, which came in the form of bribes and perquisites received from *de facto* control of state resources.

Third, it also provides the rationale behind the persistence of a shortage economy and the bias in centrally planned prices throughout the history of the Soviet Union (see Levy, 1990 and Shleifer & Vishny, 1992). That is, it explains why the incentive was to hold down prices over scarce goods and services, not keep them up, in order to perpetuate shortages. Why is this case? In a market economy, the entrepreneur who organizes the firm is the residual claimant, or the individual who absorbs the profits as well as the losses from his or her decision-making. By metering and monitoring of the marginal productivity of individual workers into team production, namely by reducing shirking by employees (Alchian & Demsetz, 1972), and by using capital and other inputs in a cost-effective manner, the entrepreneur is disciplined to earn profits and avoid losses.

From a property-rights perspective, we can usefully distinguish between cash-flow rights, or the ability to exchange resources for money, and control rights, the ability to exclude others from the use of resources. The Soviet economic system was one where control rights rested to a large degree at the management level of state-owned enterprise, but managers did not possess full cash-flow rights. This

[4] With this recognition in hand, the effectiveness of Soviet bureaucrats in achieving desired outcomes for politically connected elites could perhaps be assessed by developing notions of equity similar to the heterodox notions of tax equity defined by Mathews (2015).

meant that any losses accrued by firm managers from misallocating inputs according to consumer demands were borne by the state, in effect dispersed as costs in the form of lower standards of living to the masses of Soviet citizens. As long as output targets set by Gosplan, the central planning agency of the Soviet Union, were met and everyone received their perquisites due to them, then the firm manager was judged as a success. Moreover, any waste incurred in the production process was not penalized, since the Soviet bureaucracy was not intending to allocate resources in a wealth-maximizing manner for the Soviet citizenry, but in a manner that would maximize their own private gain from controlling the allocation of scarce resources.

In addition, at all levels of the Soviet planning bureaucracy, from the Politburo to Gosplan, the state agencies which outlined and administered central planning, set output targets, and planned prices, *no single individual* could legally accrue additional profit from increasing output beyond a pre-determined target to meet any excess demand by consumers of goods and services. Any additional output that was officially reported as produced and sold, in effect, was a 100% tax to the managers of the state-owned firms, the benefits of which would go the coffers of the state treasury. Moreover, any bureaucrat ordering an increase in the price of a good, so as to approach a market-clearing equilibrium, would not accrue the marginal revenue from the increased prices of such goods. Unable to legally derive a profit from the sale of output, it is in the mutual interest of the firm managers to restrict output and for bureaucrats to hold centrally set prices below market-clearing prices, which results in shortages (Shleifer & Vishny, 1992, p. 239). Firm managers and bureaucrats benefited from creating a shortage by being able to monetize their *de facto* control of goods and services in the form of bribes from consumers, whose valuation of such goods and services exceeded the official price ceiling. In essence, a state shortage of buns and a state shortage of sausages translates into a black market sandwich sold out the backdoor, with a corresponding high price.

Alongside this shortage economy, there emerged a secondary supply system around a special group of middlemen, known as the *tolkachi,* whose role was to fill the gaps in the failure of the state enterprises to fulfill their output targets. Acting on behalf of such state enterprises, the *tolkachi* worked to sell surplus commodities on the one hand and to purchase needed products on the other to facilitate production. On the consumption side, they attempted to correct for long queues and poor quality of consumer goods found in official state stores, namely by transforming these non-monetary costs to consumers of obtaining goods into economic gains for themselves, via black market side-payments (Boettke, 1993, pp. 65-66). While Communist Party officials enjoyed queue-free stores, the underground economy operated to prop up these missing benefits to the rest of Soviet society.

The centralization of the Soviet economy metaphorically into one big factory manifested itself as a divergence between the *de jure* system of central planning, in which property, free pricing, and profit/loss were formally abolished and their *de facto* existence, both externally in the form of black markets, and internally in the evolution of informal property rights over state-produced resources, which were monetized via exchange on the black market. Rather than produce for direct use, as outlined in the textbook model of socialism, production became divided into two categories: production in the state sector of the economy for its own sake (i.e., to maintain the illusion of socialism as a legitimizing ideal) and production for exchange, which sustained the rest of the population. It is this institutional framework that Mikhail Gorbachev inherited when he came to power in 1985.

Perestroika under Gorbachev

When Mikhail Gorbachev became General Secretary of the Communist Party of the Soviet Union, he had inherited an economic and political system that had long been stagnant and corrupt. Despite the corrupt and stagnant nature of the Soviet state, it had proved to be a remarkably stable autocracy from its inception until Gorbachev's succession. However, just as Gorbachev rose to power, the Soviet Union's bureaucracy was undergoing a massive turnover. Given the entrenched interests of the Soviet bureaucracy, the claim could be made that, under the status quo, the earlier "reform" efforts by Khrushchev, Brezhnev, Andropov, and Chernenko were not possible. However, unlike these previous autocrats, Gorbachev faced a radically different situation.

One of the consequences of Joseph Stalin's purges during the 1930s was the creation of a young and loyal cohort that would control the appointment of Soviet bureaucrats for decades. A comparison of the Seventeenth Party Congress in 1934 and the Eighteenth Congress in 1939 demonstrates this purge effect. At the 1934 Congress 80% of the delegates had joined the Party prior to 1920, but at the 1939 Congress 50% of the delegates were under 35 years old.[5] Although Stalin's purge of the "Old Bolsheviks" served, among other things, to create a layer of very young and loyal apparatchiks (Boettke, 1993, p. 82), from a political economy standpoint, it also created a situation that would later prove to be un-robust and unstable.

By the mid-1980s, the Soviet Union's aging bureaucracy began to retire or die, resulting in a "demographic transition" during this period. With them, these personnel took a network of informal contractual agreements that formed the cartelizing basis of the Soviet patronage system. This meant that "*the transaction costs associated with the realignment of rent flows and patronage opportunities were rapidly, and significantly, lowered*" (italics original, Anderson & Boettke, 1993, p.110). In effect, positions controlling rent flows went on the auction block in the mid-1980s.

However, this did not present an opportunity for Gorbachev to be a *laissez-faire* reformer of the Soviet economy. His attempts at "reform" under *Perestroika* were not instituted to change the rules of the game within the economy; they were

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[5] As Michael Voslensky (1984) points out, "In 1930, 69 per cent of the regional and district secretaries and secretaries of the central committee of the Union's constituent republics had joined the party before the revolution. In 1939, 80.5 per cent had joined the party only after 1924, i.e., after Lenin's death. Of the 1939 secretaries, 91 per cent 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 per cent had joined the party only after 1924, and 92 per cent were under forty" (p. 61).

not attempts to institute a market economy, fundamentally based on well-defined and exchangeable property rights. Indeed, the word *perestroika* in Russian means “restructuring,” but this only implied a restructuring of political appointments with the Soviet political system, not a restructuring of the system itself. Upon closer examination, the succession of Gorbachev in general and the *perestroika* reform program in particular closely resembled other Soviet government policy adjustments which followed shifts in the top leadership. Perestroika did not emerge as a central plan to end central planning and introduce a market economy, but rather represented the “Gorbachev” distribution of patronage perquisites, couched in liberalization rhetoric. Any real attempt to reform the institutional infrastructure of the Soviet economy would run contrary to the logic of political decision-making, which is to concentrate benefits on well-organized special interest groups, and disperse the costs of such policies on the masses of the population.

The most dramatic evidence of “reform” under the Gorbachev regime was the alleged relaxation of controls on private economic activity. From 1985-1991, Gorbachev introduced at least 10 major policy packages for reform under the name of *perestroika*, yet not a single one was implemented fully. An example of these half-measured attempts at reform were two key legal components of *perestroika*, which included the Law on Individual Enterprise of 1986 and the Law on State Enterprises of 1987.

The Law on Individual Enterprise allowed individuals to engage in activities which previously had been deemed illegal, the intent of which was to encourage individual economic enterprise and market experimentation. Family members of state employees or individuals such as students, housewives, and pensioners were allowed to work full-time if they desired. But in order to do so, individuals had to apply for a license granted by local authorities and pay either an annual income tax or a fee, which in particular cases was required where it was difficult to monitor income, such as driving a taxi. For example, the fee for a private taxi, in 1987, was 560 rubles, which meant that a worker who was “moonlighting” as a taxi driver had to earn the equivalent of three months’ wages before driving the taxi would cover its costs (Boettke, 1993, p. 101). Given these prohibitively high licensing fees, the unintended consequence of this policy was the persistence of a black market: very few if any of the Moscow *chastniki* (private taxis) were registered and, therefore, official. The Law on Individual Enterprise, in effect, amounted to simply regulating and taxing an activity that had gone on “unofficially” for years.

An even more fundamental problem with the law on private economic activity was the existence of the campaign against unearned income. The campaign required individuals to have appropriate documentation explaining how they had made their money, the unintended consequence of which was the emergence of an illicit market in documentation. The attitude of the regime conveyed by the campaign simply reinforced the lack of trust citizens possessed concerning the commitment of the government to reform. Without a credible conveyance of commitment to market reform, farmers, workers and so on, did not have any incentive to invest in the above-ground market.

The intended effect of the Law on State Enterprises was to reintroduce self-accounting, self-financing, and self-management of state enterprises. However, given the Soviet Union's commitment to full employment, there was no credible commitment to reintroduce true residual claimancy analogous to a firm in a market economy, in which the firm owner absorbs both the profits and losses of his decision-making. Despite whatever announcement made about self-financing, there was no precedent in previous reforms, not even from the New Economic Policy, regarding this. Given the expectation that Gorbachev would later renege on full liberalization of profits and losses, what incentive do firm managers have in this uncertain context? As long as there was a credible commitment to full employment, enterprise managers faced a "soft budget constraint," meaning they would not bear any losses, they would not be allowed to go bankrupt, and they would continue to be subsidized by the state. As a result of the contradictory goals, firm managers increasingly monetized their discretionary power by approving wage increases. In other words, they were privatizing the benefits of the law, but socializing the losses onto the rest of the economy. As a result, the Soviet Union ran increasingly large budget deficits and resorted to monetization of its debt in order to pay it off.

The inability for Gorbachev to convey any kind of commitment to reform sealed not only the fate of *perestroika*, but also the fate of his own political career. The reforms simply could not get the economy going, and the situation in the Soviet economy continued to deteriorate. The political instability of failed reforms, alongside deflated expectations on the part of the population, produced a highly troublesome situation for Gorbachev, not only costing him his credibility with his more liberal allies in the Communist Party, but also with hardline conservatives. When hardliners in the Party failed to reassert control through "constitutional" means, they resorted to an attempted *coup d'état* in 1991. It was the failure of *perestroika* that in fact led to the attempted coup, the unintended by-product of which led to the official unravelling of the Soviet Union as a political entity on December 26, 1991. Although the transition from Mikhail Gorbachev to Boris Yeltsin was peaceful, and the Cold War between the United States and the Soviet Union ended without firing a shot, the collapse of the Soviet Union took with it a horrific legacy of poverty, famine, tyranny, and murder.

Conclusion

The terrible consequences of the Soviet experience with communism were not a *behavioral* failure, but an *institutional* failure. The Soviet economy failed to achieve economic prosperity and social harmony not because the Soviet people and its leaders were self-interested and inhumane, but because the institutional rules by which the Soviet economy was organized failed to channel the self-interest of individuals in a socially beneficial, humane manner. Rather than craft a set of institutions within which bad men could do least harm, it only created the very conditions for such a tragic consequence. Its failure was not its attempt to achieve an idealistic end, but its attempt to choose a particular set of means that were inconsistent with the demands of humanity. The abandonment of private property, money prices, and profit/loss signals under a socialist utopia only led to the abandonment of our ability to cooperate in a peaceful and productive manner via exchange. With this abandonment came the embrace of the most inhumane coercive efforts to destroy the aspirations, and most unfortunately, the lives of millions of individuals, all to serve the interests of a governing elite under the justificatory guise of a unified, central plan that would supposedly deliver a just, post-scarcity world. The Soviet experience with Communism is a lesson of economic history that we must never forget, not just for pedagogical reasons, but for the sake of posterity, so as to prevent its return.

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