American Enterprise Institute for Public Policy Research

AEI

April 2007

On the Issues

The Soviet Collapse: Grain and Oil

By Yegor Gaidar

Yegor Gaidar is director of the Institute for Economies in Transition in Moscow. Between 1991 and 1994, he was acting prime minister of Russia, minister of economy, and first deputy prime minister. Between 1993 and 2003, Gaidar was a founder and a co-chairman of the Russia's Choice and the Union of Rightist Forces Parties, and a deputy of the State Duma. His most recent book, Gibel' Imperii: Uroki dlya sovremennoi Rossii *[The Collapse of an Empire: Lessons for Modern Russia], was published in 2006. The English translation of the book will be published by the Brookings Institution Press on July 30, 2007.*

In the summer of 2002, after the Russian government introduced the flat income tax, completed fiscal reforms, created the Stabilization Fund, and introduced land reform in Russia, I had a premonition that the window of opportunity for further reforms would be closing for a number of years. I was correct in my prediction.

As a result, I decided to turn to more academic pursuits. The title of my latest book, which I would like to discuss today, can be translated as *The Collapse of an Empire: Lessons for Modern Russia.*[1] It relates the story of the last few years of the Soviet Union. But when I wrote about the collapse of the Soviet Union, I also had in mind dilemmas of contemporary Russia.

There were several factors which pushed me to write this book. The first was the rise in oil prices, which in real terms have started to approach the level of the late Brezhnev period. The second was the disturbing tendency to mythologize the late Soviet period in current Russian society and popular culture. These myths include the belief that, despite its problems, the Soviet Union was a dynamically developing world superpower until usurpers initiated disastrous reforms. At least 80 percent of Russians are convinced of this flawed interpretation of history.

Historically, such myths have a dangerous precedent—namely, Germany between World War I and World War II. Then, the legend went that Germany was never defeated in the war, but "stabbed in the back" by the Jews and the Socialists. To some degree, the responsible party was the democratic German government, as it was unprepared to publish materials about what really happened before and after World War I.

Similarly, access to documents about the Soviet collapse is becoming increasingly restricted, but we were still able to make public a number of them that can properly explain what happened to our country.

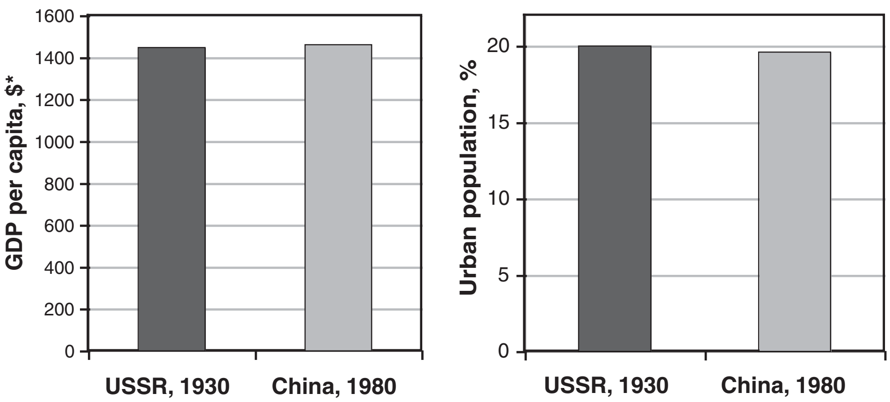
To be frank, I never thought that the book—half of which is tables, graphs, or official materials of the Soviet government—could be a bestseller in my country. Yet it is, a fact which provides a glimmer of hope.

Research assistant Igor Khrestin compiled this text from the transcript and the video recording of the lecture delivered by Yegor Gaidar at AEI on November 13, 2006, and translated the conclusion of this article from Russian. The text was edited by resident scholar Leon Aron and augmented by Mr. Gaidar.

The Story of Grain

In a simplified way, the story of the collapse of the Soviet Union could be told as a story about grain and oil. As for the grain, the turning point that decided the fate of the Soviet Union began

FIGURE 1
COMPARISON BETWEEN USSR IN 1930 AND CHINA IN 1980, BY GDP PER CAPITA AND BY LEVEL OF URBANIZATION



NOTES: All figures are taken in part from Yegor Gaidar, *Gibel' imperii: Uroki dlya sovremennoi Rossii* [The Collapse of an Empire: Lessons for Modern Russia] (Moscow: Rossiyskaya Politicheskaya Entsiklopedia, 2006), and presented at a lecture by Gaidar at the American Enterprise Institute on November 13, 2006. More information and all figures can be located in full at www.aei.org/event1420/.
* In international dollars of 1990 (Geary-Khamis dollars)

with the economic debate of 1928–29, when the discussion centered on what would later be called the "Chinese path" of development. (By several important economic and social indicators, the Soviet Union of that period and China in the late 1970s took similar approaches to reform. See figure 1.) At the time, the head of the Soviet government, Aleksei Rykov, and the chief ideologist of the Communist Party, Nikolai Bukharin, earnestly defended the idea of a path which included preserving private agriculture and the market, and ensuring financial stability—but holding onto the party's political control.

The Soviet leadership ultimately chose another path. The solution preferred by Joseph Stalin was the expropriation of peasants' property, forced collectivization, and extraction of grain. Judging from the available documents, the essence of this decision was relatively simple. Bukharin and Rykov essentially told Stalin: "In a peasant country, it is impossible to extract grain by force. There will be civil war." Stalin answered, "I will do it nonetheless."

The result of the disastrous agriculture policy implemented between the late 1920s and the early 1950s was the sharpest fall of productivity experienced by a major country in the twentieth century. The key problem confronting the Soviet Union was well-expressed in the letter sent by Nikita Khrushchev to his colleagues in the leadership of the party. The letter fundamentally stated: "In the last fifteen years, we have not increased the collection of grain. Meanwhile, we are experiencing a radical increase of urban population. How can we resolve this problem?"

Once again, a serious discussion ensued among Soviet leaders in the early 1950s, resulting in two positions. The first position was to attempt to improve the situation in the agricultural regions outside of the fertile "black soil belt" in southern Russia. The other position was to resolve the problem by utilizing the socialist planning system: large projects and a concentration of resources. Naturally, doubts lingered about whether this strategy would cause even higher fluctuations in long-term production.

But these considerations were ignored and, tactically, the strategy of dramatically expanding the land under cultivation yielded temporary success. Between the mid-1950s and the early 1960s, the amount of the grain produced by the Soviet Union increased significantly. The problem was the limited amount of suitable land and the continuing growth of the population in large cities. Thus, already in the late 1960s, the shortcomings of this plan were evident.

In 1963, Nikita Khrushchev sent a letter to the leaders of the Socialist bloc, informing them that the Soviet Union would no longer be able to supply them with grain. That year, the Soviet state bought 12 million tons of grain—and spent one third of the country's gold reserves to do so. Khrushchev commented: "Soviet power cannot tolerate any more the shame that we had to endure."[2]

Therefore, in the 1960s, state production of grain stabilized and, regardless of attempts by the Soviet leadership, remained fixed at 65 million tons per year until the late 1980s (see figure 2). The cities, however, continued to grow. What policy could succeed if a country had no increase in grain production and an 80 million–person increase in its urban population?

The picture was bleak. Russia, which before World War I was the biggest grain exporter—significantly larger than the United States and Canada—started to be the biggest world *importer* of grain, more so than Japan and China combined.

FIGURE 2
PROCUREMENT OF GRAIN IN THE USSR

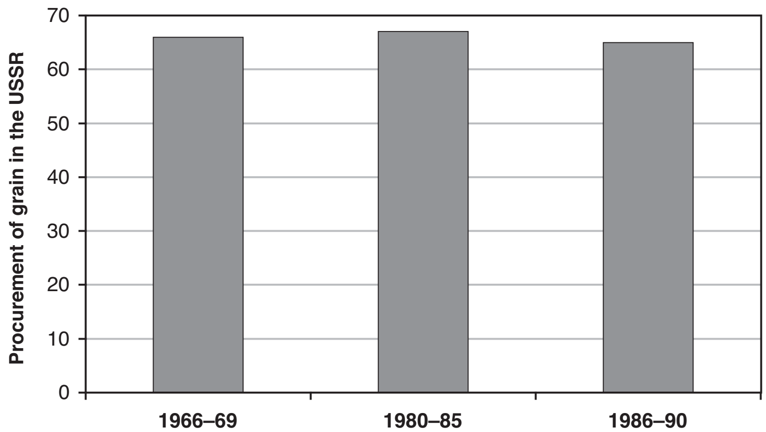
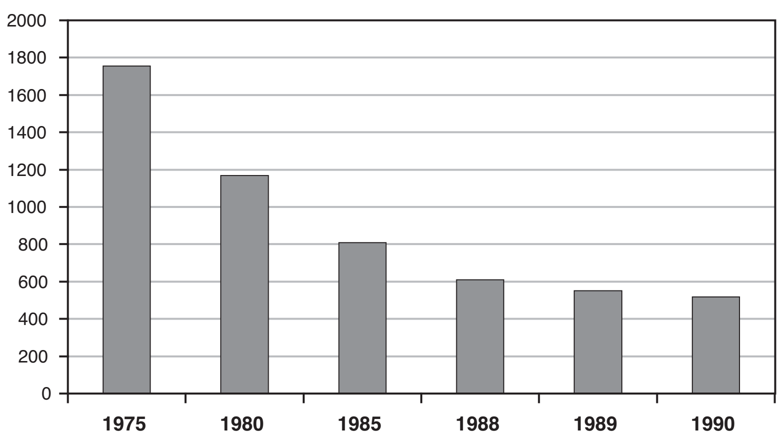


FIGURE 3
AVERAGE OUTPUT OF NEW OIL WELLS BEING PUT IN OPERATION IN THE USSR



Soviet imports had to be paid for in hard currency. Mikhail Gorbachev was quite frank in one of the meetings of the Communist Party of the Soviet Union (CPSU): "We are buying [the grain] because we cannot survive without it."[3] There were, of course, examples of nations, such as Japan, that also massively imported grain and other agricultural products. Unlike the Soviet Union, however, these nations were able to export products from their machine-building and processing industries.

Why could the Soviet Union not pursue the same policy? Because "socialist industrialization" had resulted in the Soviet industry being unable to sell any processed (value-added) products. Nikolai Ryzhkov, chairman of the USSR Council of Ministers, expressed the sentiment clearly at another meeting of the Soviet leadership: "No one will take our machinery production. That is why we are exporting mainly raw materials."[4]

The Story of Oil

The Soviet economy thus hinged on its ability to produce and export raw commodities—namely, oil and gas. The Soviet leadership was extremely fortunate: at almost exactly the time when serious problems with the import of grain emerged, rich oil fields were discovered in the Tyumen region of Western Siberia.

Already in 1970, Western Siberia was considered a large oil region by international standards. During the next twelve years, the Soviet Union increased oil production there twelvefold. There was intensive debate among the Soviet leadership about how to best exploit the Western Siberian oil. The oil industry experts warned the CPSU leadership and government State Planning Committee that it would be impossible to increase the production at such a rapid pace in the future without facing serious technical problems.

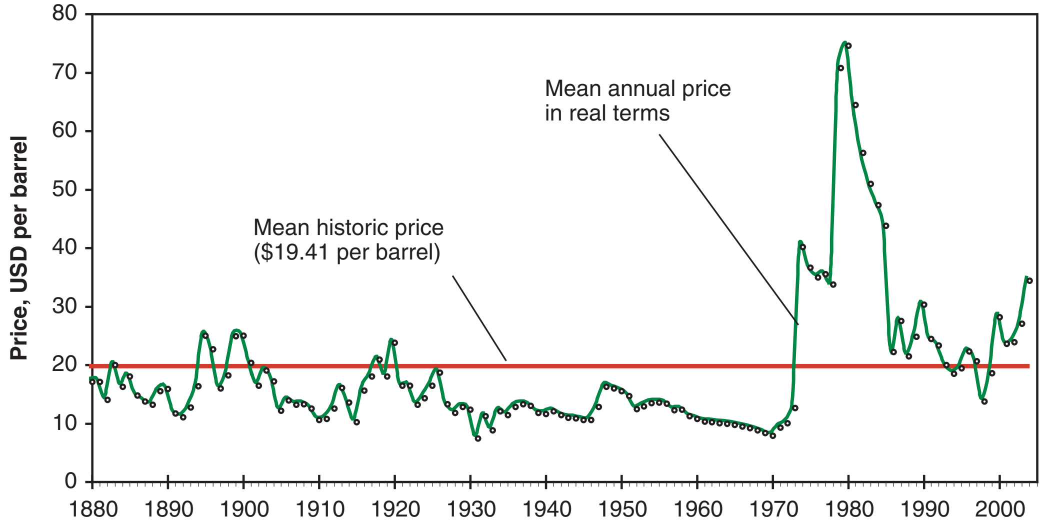
Yet the Soviet leadership told the oil ministry there was no other choice. The Soviet premier, Aleksey Kosygin, used to call the chief of the Tyumenneftegaz, Viktor Muravlenko, and explain the desperation of the situation: *"Dai tri milliona ton sverkh plana. S khlebushkom sovsem plokho"* [Please give three million tons above the planning level. The situation with the bread is awful].

The "Spanish" Curse

By 1975, the Soviet Union began having serious problems with the output of new oil wells: much higher investment was needed for the current operations to get the same output (see figure 3). But the Soviet Union was fortunate to get unusually high oil prices starting in the mid-1970s.

The oil market is peculiar because of the varying levels of elasticity of the demand and supply in both the short and the long terms. The fluctuations of prices are

FIGURE 4
DYNAMICS OF PRICES OF CRUDE OIL IN LONG-TERM PERSPECTIVE (1880–2004)



NOTE: All prices are pegged to the constant 2004 level.

enormous (see figure 4). There is a very well-known economic concept of external shocks. In the United States, the world's largest economy, the biggest external shock during the last fifty years was in 1974, when oil prices quadrupled and terms of trade worsened by 15 percent. For the Soviet Union, skyrocketing oil prices had a much more substantial effect on GDP, which could be measured in hundreds of percentage points. Thus began the collapse of the Soviet empire.

Imperial ambitions based on such unstable resources were not exclusive to the Soviet Union. The "resource curse" was well-analyzed by the School of Salamanca in the experience of Spain of the sixteenth and seventeenth centuries. The influence of the inflows of gold and the silver from America to Spain are comparable to the impact of oil and gas revenues to the Soviet Union (see figure 5). The Spanish empire, without losing a single battle on the ground for fifty years, managed to lose all of its possessions in Europe outside of the Pyrenees, including Portugal, and came very close to losing Aragon and Catalonia as well. In 1989, also without losing on the battlefield for fifty years, the Soviet Union lost control over Eastern Europe.

In the 1970s and early 1980s, the Soviet leadership, however, was not intellectually prepared to heed lessons from the School of Salamanca. The shortest quotation about the intellectual capacity of the Soviet leadership came from the Politburo minutes: "Mr. Zasiadko has stopped binge drinking. *Resolution*: nominate Mr. Zasiadko as a minister to Ukraine."

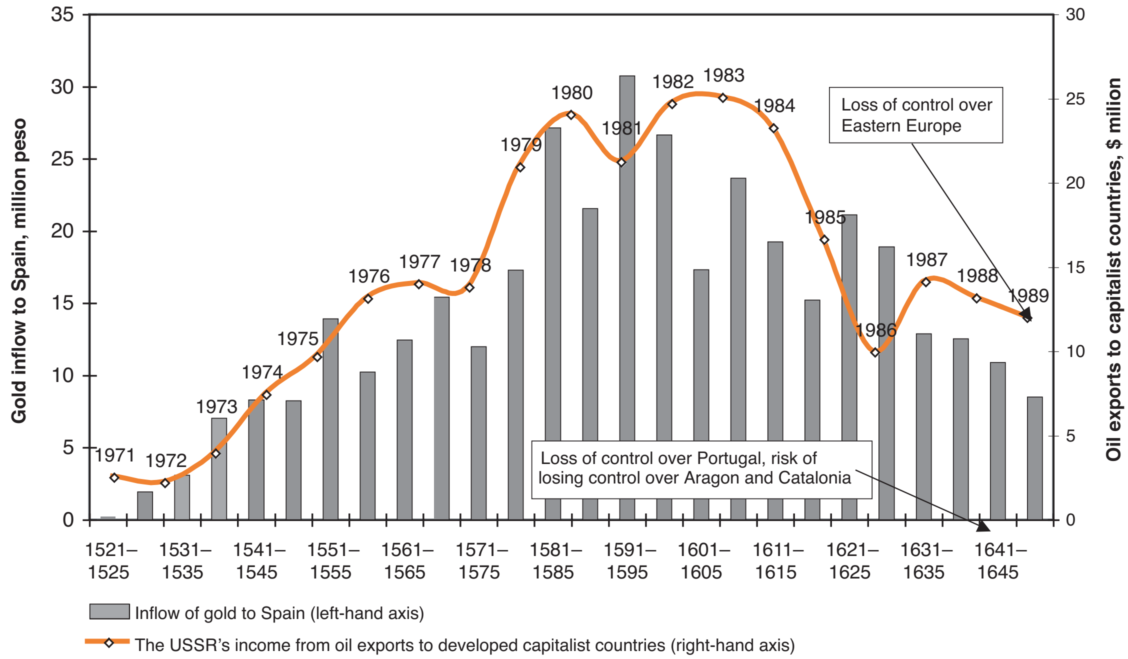
While intellectual capacity was not the strongest quality of the Soviet leadership, they still understood the need to manipulate the oil market. Excerpts from Politburo materials indicate that the head of the Committee for State Security (KGB), Yury Andropov, facilitated contacts between the KGB and the Arab terrorists, who sought assistance for terrorist attacks on oil fields in order to keep energy prices high.[5] The general resolution was that the Soviet Union should support the Arab terrorists in this battle.[6]

Yet one of the Soviet leadership's biggest blunders was to spend a significant amount of additional oil revenues to start the war in Afghanistan. The war radically changed the geopolitical situation in the Middle East. In 1974, Saudi Arabia decided to impose an embargo on oil supplies to the United States. But in 1979 the Saudis became interested in American protection because they understood that the Soviet invasion of Afghanistan was a first step toward—or at least an attempt to gain—control over the Middle Eastern oil fields.

The timeline of the collapse of the Soviet Union can be traced to September 13, 1985. On this date, Sheikh Ahmed Zaki Yamani, the minister of oil of Saudi Arabia, declared that the monarchy had decided to alter its oil policy radically. The Saudis stopped protecting oil prices, and Saudi Arabia quickly regained its share in the world

FIGURE 5

INFLOW OF GOLD TO SPAIN IN 16TH–18TH CENTURIES, AND THE INFLOW TO THE USSR OF FOREIGN CURRENCY FROM OIL EXPORTS IN 1970S–1980S



market. During the next six months, oil production in Saudi Arabia increased fourfold, while oil prices collapsed by approximately the same amount in real terms.

As a result, the Soviet Union lost approximately $20 billion per year, money without which the country simply could not survive. The Soviet leadership was confronted with a difficult decision on how to adjust. There were three options—or a combination of three options—available to the Soviet leadership.

First, dissolve the Eastern European empire and effectively stop barter trade in oil and gas with the Socialist bloc countries, and start charging hard currency for the hydrocarbons. This choice, however, involved convincing the Soviet leadership in 1985 to negate completely the results of World War II. In reality, the leader who proposed this idea at the CPSU Central Committee meeting at that time risked losing his position as general secretary.

Second, drastically reduce Soviet food imports by $20 billion, the amount the Soviet Union lost when oil prices collapsed. But in practical terms, this option meant the introduction of food rationing at rates similar to those used during World War II. The Soviet leadership understood the consequences: the Soviet system would not survive for even one month. This idea was never seriously discussed.

Third, implement radical cuts in the military-industrial complex. With this option, however, the Soviet leadership risked serious conflict with regional and industrial elites, since a large number of Soviet cities depended solely on the military-industrial complex. This choice was also never seriously considered.

Unable to realize any of the above solutions, the Soviet leadership decided to adopt a policy of effectively disregarding the problem in hopes that it would somehow wither away. Instead of implementing actual reforms, the Soviet Union started to borrow money from abroad while its international credit rating was still strong. It borrowed heavily from 1985 to 1988, but in 1989 the Soviet economy stalled completely.

The Search for Loans

The money was suddenly gone. The Soviet Union tried to create a consortium of 300 banks to provide a large loan for the Soviet Union in 1989, but was informed that only five of them would participate and, as a result, the loan would be twenty times smaller than needed. The Soviet Union then received a final warning from the Deutsche Bank and from its international partners that the funds would never come from commercial sources. Instead, if the Soviet Union urgently needed the money, it would have to start negotiations directly with Western governments about so-called politically motivated credits.

In 1985 the idea that the Soviet Union would begin bargaining for money in exchange for political concessions would have sounded absolutely preposterous to the Soviet leadership. In 1989 it became a reality, and Gorbachev understood the need for at least $100 billion from the West to prop up the oil-dependent Soviet economy. According to chairman of the State Planning Committee Yury Maslyukov:

> We understand that the only source of hard currency is, of course, the source of oil. . . . If we do not make all the necessary decisions now, next year may turn out to be beyond our worst nightmares. . . . As for the socialist countries, they may all end up in a most critical situation. All this will lead us to a veritable collapse, and not only us, but our whole system.[7]

Ryzhkov commented at the same meeting:

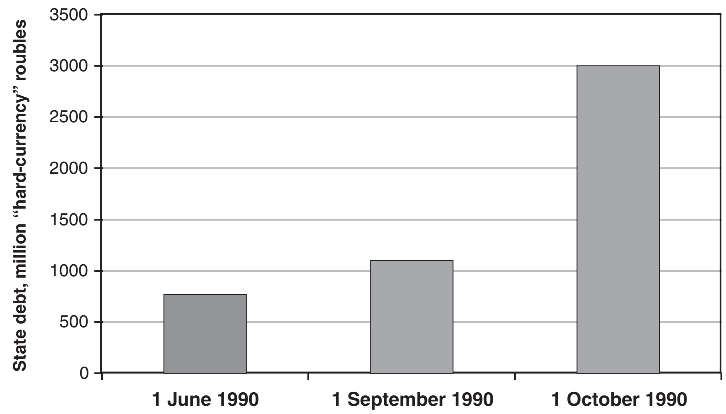
> The Vneshekonombank's [Soviet Foreign Trade Bank] guarantees are needed, but it cannot provide them. . . . If there is no oil, there will be no national economy.[8]

It is fascinating to hear now the opinion that Eduard Shevardnadze, then foreign minister, "betrayed" the interest of the Soviet Union—especially when documents that were prepared for him at the time are available. In reality, a number of Soviet agencies urged him to secure at any cost these "politically motivated credits."[9]

In the meantime, the Soviet Union started to have severe food shortages, and grain deliveries were not being made to large cities. One of Gorbachev's closest associates, Anatoly Cherniayev, described the situation in Moscow in March 1991:

> If [the grain] cannot be obtained somewhere, famine may come by June. . . . Moscow has probably never seen anything like that throughout its history—even in its hungriest years.[10]

FIGURE 6
STATE DEBT TO FOREIGN SUPPLIERS



The Crash

When the situation in the Soviet Union is examined from financial and hard currency perspectives, Gorbachev's policies at the time are much easier to comprehend (see figure 6). Government-to-government loans were bound to come with a number of rigid conditions. For instance, if the Soviet military crushed Solidarity Party demonstrations in Warsaw, the Soviet Union would not have received the desperately needed $100 billion from the West. The Socialist bloc was stable when the Soviet Union had the prerogative to use as much force as necessary to reestablish control, as previously demonstrated in Germany, Hungary, and Czechoslovakia. But in 1989 the Polish elites understood that Soviet tanks would not be used to defend the communist government.

The only option left for the Soviet elites was to begin immediate negotiations about the conditions of surrender. Gorbachev did not have to inform President George H. W. Bush at the Malta Summit in 1989 that the threat of force to support the communist regimes in Eastern Europe would not be employed. This was already evident at the time. Six weeks after the talks, no communist regime in Eastern Europe remained.

Of course, the West was still careful about directly supporting independence movements inside the Soviet Union. When the Lithuanian authorities approached the American embassy in Moscow to ask whether the United States would lend support to the independence of Lithuania, the immediate response was negative. When the Soviet Union tried to use force to reestablish control in Baltic states in January 1991, however, the reaction from the West—including from the United States—was fairly straightforward: "Do as you wish, this is your country. You can choose any solution, but please forget about the $100 billion credit."

What were Gorbachev's options at the time? He could not easily dissolve the Soviet empire; the conservative elements inside the Soviet leadership were strongly against this notion. Yet he could not prevent the dissolution of the empire without a massive use of force. But if force was employed, the Soviet state would not get the necessary funds from the West, without which Gorbachev had no chance of staying in power.

This conundrum was the source of Gorbachev's dilemma, forcing him to strike a deal with both the military and Boris Yeltsin. Hardliners from the KGB and the army who perceived that Gorbachev was simply too weak of a leader staged a coup in August 1991 under the banner of the State Committee for a State of Emergency (GKChP).

Within three days it was clear, however, that the plot had failed because its leaders did not know how to deal with the situation. Even if they found one division able to crush all the people who demonstrated against the GKChP, would the grain appear? Where would they find the food necessary to feed the larger cities? Would the West rapidly give the $100 billion? Their case, like the Soviet state itself, was entirely lost.

On August 22, 1991, the story of the Soviet Union came to an end. A state that does not control its borders or military forces and has no revenue simply cannot exist. The document which effectively concluded the history of the Soviet Union was a letter from the Vneshekonombank in November 1991 to the Soviet leadership, informing them that the Soviet state had not a cent in its coffers.[11]

* * *

What lessons can we learn from the Soviet collapse and apply to the current situation in Russia? First, we must remember that Russia today is an oil-dependent economy. No one can accurately predict the fluctuations of oil prices. The collapse of the Soviet Union should serve as a lesson to those who construct policy based on the assumption that oil prices will remain perpetually high. It would seem that in our country, which has lived through the collapse of the late 1980s and early 1990s, this fact would be evident. But as soon as the prices went up again at the beginning of 2000 and in 2004 became comparable in real terms to those at the beginning of the 1980s, the idea that "high oil revenues are forever" has gained an even wider acceptance.

Of course, the Russian government has taken into account some lessons from the experience of the Soviet collapse and has been conducting a careful policy during the current period of high oil prices. The administration has accumulated a considerable reserve of foreign currency, "sterilized" a significant portion of oil revenues in the Stabilization Fund, and approached budgetary spending with great care. Nevertheless, the temptation to take and immediately divide these revenues is great. Those who argue on every television channel or newspaper about how to better spend these relatively modest funds, which would only be enough for maintaining stability for two to three years if oil prices decline, should read again the documents that demonstrate how a seemingly stable superpower disintegrated in only a few short years.

One more lesson that is relevant for Russian politics today is that authoritarian regimes, although displaying a façade of strength, are fragile in crisis. In conditions of relative stability, society is prepared to tolerate the lack of real elections. People are prepared to come to terms with this situation as an inevitable and habitual evil. But they will do so only until the country encounters a serious challenge, requiring decisive and tough measures in order to adapt to unfavorable conditions.

In this latter case, it becomes evident that the "contract" between authoritarian rulers and their subjects—which secures stability by people's tolerance of the authorities and the authorities' noninterference in people's affairs—will need to be reexamined. Such reevaluation undermines the regime. The rulers, who for the longest time have insisted that their rule is the best, find it hard to ask for and get broad societal support in a moment of crisis. In this situation, the society has a habit of answering, "For many years, we were told that we are led to a 'brighter future,' but now you would like us to tighten our belts. Instead, tighten your belts—or leave."

Russia does not need new upheavals. During the course of the twentieth century it saw enough of them. In this regard, the understanding by the elites and society that a real democracy is not an ideological dogma or something imposed by the West, but rather an important precondition for the stable development of the country, will finally give Russia the hope of escaping crises and cataclysms. This realization is vitally important for Russia's development in the next decades.

Notes

1. Yegor Gaidar, *Gibel' Imperii: Uroki dlya sovremennoi Rossii* [The Collapse of an Empire: Lessons for Modern Russia] (Moscow: Rossiyskaya Politicheskaya Entsiklopedia, 2006), available at www.iet.ru/publication.php?folder-id=44&publication-id=8912.

2. "Presidium of the Central Committee of the Communist Party of the Soviet Union (CPSU). 1954–1964: Unofficial Protocol Notes of Proceedings. Stenograms. Directives". 2nd ed., v.1. p. 778.

3. "Stenogram of the CPSU Central Committee Plenum, January 27–28, 1987". The Russian State Archive of Contemporary History (RGANI), fond [record group] 2, opis' [series] 5, delo [file] 45, list [page] 3.

4. Nikolai Ryzhkov, *Desyat' let velikih potryaseniy* [Ten Years That Shook the World] (Moscow: Kniga. Prosveshchenie. Miloserdie, 1995), 229.

5. A note from Yury Andropov, the head of the Committee for State Security (KGB), to the general secretary of the Central Committee of the Communist Party of the Soviet Union Leonid Brezhnev. "O konspirativnoy vstreche rezinenta KGB v Livane c V. Haddadom" [Regarding the Conspiratorial Meeting of a KGB Resident in Lebanon with V. Haddad.] April 23, 1974. No. 1071-A/OV. www.2nt1.com/archive/pdfs/terr-wd/plo75a.pdf.

6. A note from Yury Andropov, the head of the Committee for State Security (KGB), to the general secretary of the Central Committee of the Communist Party of the Soviet Union Leonid Brezhnev. "O peredache V. Haddadu partii inostrannogo oruzhiya i boepripasov k nemu" [Regarding the Handover of a Consignment of Foreign-Made Weapons and Ammunition to V. Haddad]. May 16, 1975. No.1218-A/OV. www.2nt1.com/archive/pdfs/terr-wd/plo75d.pdf.

7. Stenogram from the meeting at the office of the chairman of the Council of Ministers of the USSR Nikolai Ryzhkov. "O postavke dlya gosudarstva nefti, gazovogo kondensata i nefteproduktov v 1991 godu." [Regarding the Deliveries for the State of Oil, Gas Condensate, and Oil Products in 1991]. State Archive of the Russian Federation. fond [record group] 5446, opis' [series] 162, delo [file] 379, list [page] 131–137, 143–149.

8. Ibid.

9. "Pamyatnaya zapiska dlya besedy E. Shevardnadze s G. Kolem" [Memorandum for the Discussion between Eduard Shevardnadze and Helmut Kohl]. State Archive of the Russian Federation fond [record group] 5446, opis' [series] 162, delo [file] 1464, list [page] 83–84.

10. Anatoly Chernyaev, *Dnevnik pomoshchnika Prezidenta SSSR* [The Diary of an Assistant to the President of the USSR], (Moscow: TERRA, Respublika 1997), 124–26.

11. A note from A. P. Nosko, deputy head of the Vneshekonombank [Foreign Economic Bank of the USSR] to the State Committee for Operative Management of the USSR National Economy. "Ob ischepanii likvidnykh valyutnykh resursov" [Regarding the Exhaustion of Liquid Hard Currency Resources]. 26 November 1991. State Archive of the Russian Federation. fond [record group] 5446, opis' [series] 163, delo [file] 1504, list [page] 11–12.

When the Soviet Unionâ€™s oil and gas revenue dropped dramatically, the USSR began to lose its hold on Eastern Europe. Meanwhile, Gorbachevâ€™s reforms were slow to bear fruit and did more to hasten the collapse of the Soviet Union than to help it. A loosening of controls over the Soviet people emboldened independence movements in the Soviet satellites of Eastern Europe. Political revolution in Poland in 1989 sparked other, mostly peaceful revolutions across Eastern European states and led to the toppling of the Berlin Wall. grain and oil. As for the grain, the turning point. that decided the fate of the Soviet Union began. 1150 Seventeenth Street, N.W., Washington, D.C. 20036 202 .862.5800 www.aei.org. O. n t h e I s s u e s. The Soviet Collapse: Grain and OilBy Yegor Gaidar. Yegor Gaidar is director of the Institute for Economies in Transition in Moscow. Between 1991 and 1994Â The text was edited by residentscholar Leon Aron and augmented by Mr. Gaidar. April 2007. 8/14/2019 The Soviet Collapse: Grain and Oil. 2/8. with the economic debate of 192829, when the dis