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A Victory for Economic Reason

In the run-up to Gorbachev's visit to the heads of state and government of the seven most potent industrialised countries in the world assembled for this year's world economic summit, observers concurred that the Soviet President would be asking for, and perhaps getting, a lot of money – tens, or perhaps even hundreds, of billions of dollars. Caricatures showed the highest representative of the Soviet Union – a superpower which until recently ranked equal to the USA – with an outstretched hand, or even as a beggar, his hat on the pavement before him, sitting in front of Lancaster House. Fears were expressed that Gorbachev would demand massive financial support for his policies by more or less openly threatening that the failure of his policy of perestroika could mean a return to the cold war. The odds were at least in favour of a deal being reached between the Soviet Union and the Group of Seven based on the Yavlinski-Allison Plan, with the seven pledging instalments of unprecedented dollar aid in exchange for phased economic reform towards free enterprise.

None of these expectations was fulfilled. Many subjects were discussed with Gorbachev, least of all, though, money. Despite the ruinous state of the Soviet economy and the secession endeavours of six of the fifteen former Soviet republics, Gorbachev is well aware of the importance of his country, which is still a superpower in military terms. He neither wanted to nor could he have come to London cap in hand. Domestic politics and his own self-respect would not have permitted this, particularly as he is realistic enough to know that to beg for or extort billions of dollars would only win him a short breathing-space, but in the medium term not only fail to remedy but rather exacerbate his country's economic plight.

At the latest after Gorbachev's latest reform plan had become known, an obvious mix of the Harvard programme and the crisis management plans of the conservative Prime Minister Pavlov, there was no longer any prospect of an agreement being reached modelled on the IMF conditionalities offering money for reform. In the present situation, where the battle for power between Gorbachev and the conservative forces has evidently still not been decided and the Union Treaty has not yet been negotiated, Gorbachev obviously could not commit himself to the Yavlinski-Allison Plan.

Many Western commentators have been prompt in voicing bitter remonstrations at Gorbachev having to board his plane home with empty pockets. They see the London summit as a failure for Gorbachev and they place the blame on the miserliness of the wealthy Seven. A realistic assessment of the London agreements between the G7 and Gorbachev, however, reveals that until now the discussion on help for the Soviet Union has been far too narrowly confined to capital assistance.

The advocates of immediate, massive capital aid are making two false assumptions: they are proceeding on the premise that Western loans can make an essential contribution to solving Soviet economic problems at the present time and that the West is capable of granting an almost unlimited volume of such credit.

In truth, the possibilities open to the seven as far as assistance for the Soviet Union is concerned are by no means unlimited. Except for Japan, all seven countries have run up a deficit on current account; all Seven are burdened with more or less high budget deficits. Even if the Seven were prepared to raise taxes or cut other spending to help the Soviet Union, in view of the country's sheer size and the totally ruined state of its economy as a result of seventy years of socialism the volume of credit the Seven could issue to the Soviet Union would hardly suffice to make more than a marginal contribution to the economic recovery of this huge empire.

An even more crucial consideration is that massively raising its indebtedness further at the present time poses a very serious problem for the Soviet Union itself: it is already having great trouble servicing its foreign debt of some US\$ 60 billion. In the present situation marked by intransparent power relations and an acute economic crisis in the country, fresh loans would in all probability largely be expended on consumption. This would ease the pressure on Gorbachev, but would not help to solve the economic problems of the country, which stem from the system. On the contrary, new credit would enable the conservative forces in the Soviet leadership to again sidestep harsh reality, which calls for resolute reforms in the direction of free enterprise, and to muddle on as before. Even conditional loans, i.e. credit in exchange for binding reform pledges, would be problematical, since past experience with conditionalities indicates that keeping to obligations entered into is more the exception than the rule.

So, we must face the fact not only that the scope of capital assistance by the G7 for the Soviet Union is limited but above all that at the present time the Soviet Union is not capable of ensuring the productive allocation of foreign currency credit.

This does not mean that Western capital aid is not necessary or that it could not be used to good effect. However, it is precisely because there is no surfeit of Western capital that it should be deployed only when a point in time has been reached where its optimum effectiveness is assured. This will not be the case until the respective powers of the central government and the Soviet republics have been clearly demarcated and when the preconditions for the optimal allocation of scarce foreign capital are more or less in place, i.e. when an appropriate regulatory framework for free enterprise has been established. Western capital aid cannot work miracles. The Soviet Union is too big for this and the ability of the Western countries to support it with capital aid too meagre. After all, Eastern Europe and the Third World also expect support.

Unspectacular as they may appear in comparison to the expectations prior to the summit, the London agreements, aimed at providing technical assistance and helping to integrate the Soviet Union into the world economic order, deserve to be rated more as a victory for economic reason than as a failure.

Its associate membership of the International Monetary Fund and the World Bank will bring the Soviet Union closer to the world economy and it will be able to make extensive use of the economic know-how of these organisations. This gives ground for the hope that the Soviet Union will finally embark decisively on the transition to a market economy and create the preconditions necessary for the successful application of Western capital aid. Only when this has been done will massive Western loans make sense.

Dieter Lösch