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The Role of Inflation in Soviet History: Prices, Living Standards, and Political Change

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The Role of Inflation in Soviet History:

Prices, Living Standards, and Political Change

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by

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ABSTRACT

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This thesis discusses the interaction between inflation, living standards, and political change in Soviet/Russian history. It traces the establishment and evolution of the Soviet monetary system, inflationary episodes, and their consequences.

The goal of this study is to show how inflation affects the lives of ordinary people and how it has contributed to larger changes in Soviet history. Sources include economic statistics and analysis from articles and monographs, as well as first-hand accounts from interviews and newspapers.

The results show that inflation was a factor in both the rise and the fall of the Soviet Union. Russia's first hyperinflation (1917-1923) nearly destroyed the economy, and the Bolsheviks were forced to stabilize prices. The Soviet system of price controls prevented inflation, but it also created persistent shortages of food and consumer goods. Mikhail Gorbachev tried to alleviate these problems, but his efforts resulted instead in Russia's second hyperinflation (1992-1993).

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CHAPTER 1

INTRODUCTION

Price changes, or the lack thereof, were an important factor in determining living standards and influencing politics throughout the history of the Soviet Union and 20th century Russia. In fact, the Soviet Union was both founded and dissolved in the midst of high inflation. The Bolsheviks took over after high food prices helped bring down the previous governments. However, their initial policies led to Russia's first hyperinflation, widespread suffering, and domestic unrest, so they had to stabilize the ruble and the economy in order to remain in power. After Stalin took charge, the Soviet economy struggled with inflation for two decades, until a currency reform in 1947 finally established a stable monetary system based on fixed prices. Although price controls prevented inflation, they also created persistent shortages of food and consumer goods, which were the most common complaints about the economy by Soviet citizens. Finally, Gorbachev's efforts to save the Soviet economy from shortages and stagnation resulted instead in another hyperinflation and the Union's collapse. The inflation and chaos of the early 1990s has made Russians skeptical of democracy and free markets, and voters have repeatedly chosen stability at the expense of political and economic freedom.

Inflation first started in the Russian Empire during the First World War and led to higher food prices in the cities, which were major factor in creating urban discontent and bringing down both the imperial and provisional governments. However, when the Bolsheviks took over, they made living conditions even worse by trying to create a moneyless economy. This attempt, known as war communism, created hyperinflation, a major famine, shortages of goods, and rebellions by peasants and sailors. The Bolsheviks were forced to establish a stable currency and allow some market activity in order to keep from being overthrown like the two governments before them. They managed to stabilize the ruble by balancing their budget and backing the currency with gold. The economy made an astounding recovery in the 1920s under the New Economic Policy, but industrial prices rose much faster than agricultural prices on the open market. The Bolshevik leaders responded by crowding out private merchants and re-imposing price controls. They also continued to purchase grain from the peasants at artificially low rates, which made them reluctant to sell. These factors inspired the decision to proceed with full-scale state industrialization and collectivization.

During the Stalin years, the Russian economy had different types of stores with varying degrees of price controls and inflation. Strict price controls were in place in most state stores and co-operatives, while others were allowed to sell at higher regulated rates. While these stores had low prices, they also had shortages and a poor selection of products. In contrast, collective farm markets were completely free to set their prices according to market forces, but their prices were usually much higher. During the Second World War, the government started running budget deficits and printing too much money again, leading to even higher inflation. State stores and co-operatives remained under price control and had relatively moderate inflation, but the collective farm markets had price increases that bordered on hyperinflation. Inflation began to decline in 1944, after the Soviet government balanced its budget, and was eliminated completely after a currency reform in 1947.

The peculiar monetary system of the Soviet Union managed to avoid open inflation for most of the post-Stalin era, but that does not mean inflationary pressures did not exist before Gorbachev's time. Consumer prices remained stable for many decades because they were fixed and subsidized by political authorities and did not reflect supply and demand. Yet despite their best efforts, the authorities could not quash the effects of market forces completely. While retail prices remained virtually unchanged, workers' wages continued to climb over the years. This created what is known as repressed inflation, which can be defined as rising excess demand that leads to excess liquid assets in the hands of the population instead of higher prices.[1] As a result, consumers constantly faced shortages, because production was responsive only to government plans, and growing demand did not lead to higher supply.

The system of price controls had deleterious effects both for Soviet consumers and for the economy as a whole. Decades of neglect left Soviet citizens with much lower incomes and living standards than people had in the West. Shortages of most foods led to lower quality diets, and many consumer products that were routines available in the West, such as telephones, cars, and modern washing machines were amazingly rare in the Soviet Union. Living conditions were less comfortable in many ways, with less housing space per person, no central heating, no air conditioning, and often no sewer connections or hot water. When consumers could not find anything they wanted to buy, many chose to save a portion of their income every year. This effect was cumulative over the years, as unsatisfied demand from each year was carried over to the next and the population's savings continued to grow. By 1985, the Soviet economy had amassed a large monetary overhang, as the money supply had grown to become many times larger than what was needed for regular circulation. While these problems had been building prior to 1985, the economic situation rapidly deteriorated during the Gorbachev years.

The last Soviet leader knew that the economy needed to be reformed, but his efforts only aggravated its existing problems. Workers' wages went up more than ever, but the supply of consumer goods remained too low, and prices remained fixed. Government budget deficits grew to unsustainable levels and had to be financed by simply printing more money to cover the shortfalls. These new monetary emissions further contributed to the existing overhang, and the money supply became dangerously excessive. In late 1991, the Soviet Union collapsed without solving the economic problems it had created and left its successor states to deal with the aftermath. When Russia and the other newly independent republics finally freed most prices from controls in 1992, inflation for the year reached quadruple digits. The economic and social effects were devastating. Production broke down and shortages initially worsened, making food and other basic necessities even more difficult to find. People's savings, which they had often been building for years, were wiped out. Russia's GDP dropped by at least one-third in four years, and real incomes dropped for all but the wealthiest segment of society. The hyperinflation of the 1990s has discredited free markets and democracy in the eyes of many Russians and led to them to desire stability at all costs, even if it is brought by an authoritarian leader.[2]

[1] D. M. Nuti, "Hidden and Repressed Inflation in Soviet-type Economies: Definitions, Measurements, and Stabilisation," *Contributions to Political Economy*, Vol. 5, No. 1, (1986): 46.

[2] Stefan Hedlund and Niclas Sundström, "The Russian Economy after Systemic Change," *Europe-Asia Studies*, Vol. 48, No. 6 (Sep., 1996): 889, 893, http://www.jstor.org/stable/152632 (accessed on November 2, 2010); Mark Harrison, "Coercion, Compliance, and the Collapse of the Soviet Command Economy," *The Economic History Review*, New Series, Vol. 55, No. 3 (Aug. 2002): 398, http://www.jstor.org/stable/3091673 (accessed on November 11, 2010).

CHAPTER 2

RUSSIA'S FIRST HYPERINFLATION

Like many other countries, Russia and the Soviet Union suffered from hyperinflation following the First World War. In fact, most of Central and Eastern Europe was engulfed in hyperinflation between 1919 and 1924, including Germany, Austria, Hungary, and Poland, so Russia was hardly unique in that regard. The causes of these inflations are easily identifiable and were largely due to the aftermath of The Great War and subsequent economic policies. With few exceptions, all of the countries were facing the consequences of excessive wartime spending, large government budget deficits, physical destruction, output collapse, territorial and population loss. As a result of the economic and budgetary problems, the governments of these countries resorted to issuing ever-increasing amounts of unbacked paper money to finance their expenditures. Invariably, these policies caused hyperinflation and economic chaos. Russia's case followed all of these patterns except for one major difference. In 1919, the Bolsheviks started trying to intentionally abolish money and establish a centrally planned economy based on in-kind distribution. It was this specific decision, based on their ideology, that created hyperinflation and almost completely destroyed the Russian economy. Nevertheless, the ruble was stabilized virtually the same way as all the other currencies that were devalued around the same time.[1] Due to a collapse in output and growing unrest, the Bolsheviks were forced to admit that allocating resources without the use of money was impossible, so they balanced their budget, issued a gold-backed ruble, and partially legalized private trade.

Background

The background to Russia's first hyperinflation shared many similarities with the contemporary ones of its neighbors. Prior to the war, the ruble had 98 percent gold backing and was one of the most stable currencies in the world. The Russian economy was growing rapidly and there were signs that the capitalist reforms of Witte and Stolypin[*] had put Russia on track to eventually become one of the wealthiest countries of Europe. Certainly, this is not to say that most Russians were prosperous or even content, but the economy was at least heading in the right direction. The First World War reversed this trend and inaugurated a decade of high inflation and general economic failure. Like the other belligerents, the Russian Empire had to shift all available resources to the war effort, to the detriment of other economic activity. Russia ended up spending a similar amount of money on the war as France and the United States, but Russia's government had much greater difficulty financing the expenditures than the Western powers. The imperial government relied heavily on foreign borrowing to cover its budget deficits, which limited the amount of money it needed to print to some degree. However, per capita income for Russia's citizens was three to five times lower than England, Germany, or France, which made it difficult for the Russian state to extract revenue from domestic sources. All of the war's participants went off of the gold standard and began issuing unbacked paper currency, but the lack of revenue led the Russian state to print money faster than the other major powers.[2]

The imperial government's wartime policies resulted in economic chaos and its own political downfall. By the start of 1917, the amount of rubles in circulation had increased four to six times, depending on the source. In comparison, the volume of banknotes increased by 100 percent in France, 200 percent in Germany, and during the course of the whole war, while Great

[*] Sergei Witte was Imperial Russia's Finance Minister from 1892 to 1905. Witte is known for leading construction of the Trans-Siberian Railway and Russia's industrialization. Pyotr Stolypin was the Russian Prime Minister from 1906 to 1911. Stolypin undertook an agrarian reform with the goal of privatizing peasant communal land.

Britain money supply actually remained stable. Not surprisingly, this created greater inflation in Russia than in the other three countries. The war also created food shortages by breaking down transportation networks and sending farm workers to the front. The Russian people began to feel the effects of inflation and shortages in the fall of 1915. The result was essentially a redistribution of wealth from the urban population to the rural. While city dwellers struggled to find and afford food, peasants made unprecedented profits from selling their produce and livestock. As the war continued, the food-producing regions of the south had increasing difficulty shipping their food to the north, and shortages became especially severe in Petrograd. In late February of 1917, hundreds of thousands of workers (mostly women) filled the streets to protest food shortages, the war, and the autocracy. Soldiers refused to fire on the crowds and soon joined them in open rebellion, marking the end of the Tsar Nicholas II's authority. Although it would be a stretch to say economic reasons alone brought down the autocracy, they clearly played a role. After years of maintaining a stable currency, the Russian Empire collapsed in the midst of high inflation and food shortages, a situation that was later mirrored by the demise of the Soviet Union. The obvious difference was that Imperial Russia's economic and political demise was also brought about by the loss of about 1.7 million men and widespread destruction from the war.[3]

The imperial government's devaluation of the ruble was continued by the succeeding revolutionary governments. Despite the population's great discontent with the war, rising prices, and the inadequate food supply, the Provisional Government chose to continue the war effort. This decision ensured that the economy's problems would continue and soon brought down this new government as well. The Provisional Government issued a new ruble, known as the "Kerenki" after its leader Alexander Kerensky, but this did nothing to curb inflation. Meanwhile, Kerensky's government continued to rack up huge budget deficits from the war effort. By one estimate, military expenditures for 1917 were almost exactly equivalent to the year's budget deficit.[†] The Provisional Government financed its deficit by printing nine billion additional rubles, which almost doubled the money supply from the time they took power to the end of their tenure. Serious shortages of food, clothes, shoes, and other manufactured goods continued due to the war's disruptions on manufacturing, transportation, and trade. Neither the Provisional Government nor the parallel Soviets (workers' councils) were able alleviate the supply problems, and the Russian people continued to suffer. Given this situation, it is unsurprising that Lenin's slogan of "Peace, Land, and Bread" was highly appealing to the Russian masses.[4]

Of course, World War I was only the first of successive catastrophes that befell Russia, and it was soon overshadowed by the Bolshevik Revolution and the Civil War. This was true on many fronts, including the monetary situation. The Civil War and the Bolshevik economic policy known as War Communism led to the collapse of the ruble and even greater economic deprivation than the Russians had experienced during the First World War. As soon as they took power, the Bolsheviks set out to transform Russian society according to textbook socialist principles. The policies that lasted from 1918 to 1921 became known as "War Communism." The goal of War Communism was for the state to take complete control of the nation's economy and reorganize it in a more "rational" manner that would benefit the proletariat. Lenin's first priority was to nationalize the banks, which he believed held all the power under capitalism. Accordingly, by the end of the first winter, the Bolsheviks nationalized all of Russia's banks and placed them under the control of the State Bank, which they renamed the People's Bank. The bank continued to issue billions of unbacked Kerenki rubles in 1918, but the money supply

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[†] Although exact figures for such a chaotic year may be unreliable, Pethybridge cites an estimate that puts the deficit for 1917 at 22,568 million rubles (same as Katzenellenbaum) and military expenditures at 22,561 million rubles.

actually grew at a slower rate than in had in the previous year.[5]

Table 1. Amount of Paper Currency in Circulation, 1914-1924

Date	*Amount (in millions of rubles)*
July 1, 1914	1,630
Jan. 1, 1915	2,947
Jan. 1, 1916	5,617
Jan. 1, 1917	9,097
Mar. 1, 1917	9,950
Oct. 23, 1917	18,917
Jan. 1, 1918	27,300
Jan. 1, 1919	60,800
Jan. 1, 1920	225,014
Jan. 1, 1921	1,168,600
Jan. 1, 1922	17,543,900
Jan. 1, 1923	1,994,500,000
Jan. 1, 1924	178,510,000,000

Source: Katzenellenbaum, 56-58.

Hyperinflation

The floodgates to hyperinflation opened in May of 1919 when the Bolsheviks gave the People's Bank permission to print as much money as it deemed necessary for the economy. The bank started literally printing money as quickly as it could, and the supply of paper money began to grow at an exponential rate. Starting in 1919, the Bolsheviks also began issuing their own paper currencies, which they called *sovznaki*, or Soviet tokens, in a semantic attempt to deny that they could not dispense with the use of money. In fact, they virtually did destroy the ruble, as all of the revolutionary currencies became worthless and Imperial rubles were hoarded out of circulation. Peasants had to resort to bartering or using bread and salt as currency, while the government had to pay workers in kind by rationing out supplies. Although the Bolsheviks realized by 1921 that they could not effectively dispense with money and needed to establish a stable currency, hyperinflation did not reach its apex until 1923. The following chart shows the enormous growth rates of prices and the money supply.[6]

Table 2. Yearly Money Emissions and Price Increases, 1913-1923

Year	*Amount of New Paper Currency Issued (in Millions)*	*Percentage Increase in Money Supply*	*Price Index for Moscow**	*Price Index for Whole of Russia*	*Percentage Increase in Prices for Russia*
1913	-	-	1.00	1.00	-
1914	1,317	77.1%	1.01	1.01	28.7%
1915	2,670	90.6	1.30	1.30	20.0
1916	3,480	61.2	1.56	1.55	93.5
1917	16,403	180.3	3.15	3.00	683.3
1918	33,500	119.2	27.80	23.50	597.5
1919	164,200	302.5	278	164	1,375.6
1920	943,600	419.3	4,180	2,420	594.2
1921	16,375,300	1402.0	24,600	16,800	1,614.3
1922	1,976,900,000	11,268.2	244,000	288,000	7,196.9
1923	176,505,500,000	8,849.6	20,750,000	21,015,000	-
Oct., 1923	-	-	638,000,000	648,230,000	-

*Price indexes show where prices stood on January 1 of the given year, except for the last numbers available from October 1st. The other columns include changes that occurred over the course of each entire year.

Source: Katzenellenbaum, 59, 74-75.

As with the contemporary hyperinflations of Central Europe, one factor in the Russian economy's decline was territorial loss. The Bolsheviks ended the war with the Central Powers by signing the Treaty of Brest-Litovsk in March of 1918, but this came at a cost of several modern countries' worth of territory. The Germans did not have the manpower to hold the territory and were forced to pull out by the end of the year, but other hostile armies soon filled the vacuum. As Russia exited the Great War, the Civil War between the Bolsheviks and their opponents spread across the country. Various opposing armies marched across former Russian territory, destroying railways, roads, and materials in the process. The Bolshevik center lost several important agricultural and industrial regions to the White Armies in late 1918 and did not reestablish control until 1920. The loss of Ukraine's wheat and oil fields was particularly damaging to the already crippled Russian economy, as well as those of the North Caucasus. Other losses included the textiles of Turkestan and the Baltics, the Donets coal basin, and most of Russia's iron and steel factories. The Bolsheviks defeated the White Armies by late 1920 and fully routed the anarchist Black Army the following year. The invasion of Poland in 1920 ended in defeat for the Red Army, and Russia concluded the Treaty of Riga with Poland in March 1921. In this treaty, Ukraine and Belarus were divided up with Poland, and Russia regained control of the eastern halves of these lands. Poland and the Baltic States remained independent states and were not reconquered by Russia until the Second World War.[7]

There is no hyperinflation on record that is not correlated with large government budget deficits, and Russia's first was no different. The Imperial government ran a deficit of 39 percent in the first year of the war and around 75 percent the next two years. However, it was still able to cover a good portion of these deficits with loans, and less than one-third of the deficits of 1915 and 1916 was covered by issuing paper money. In 1917, the deficit reached 81.7 percent and the percentage covered by note issue went up significantly to 73 percent. As shown earlier, the Provisional government greatly increased the rate of currency issue to cover its budget shortfalls. When the Bolsheviks took over, their deficits grew even larger than those of the previous governments, and they started covering them entirely via the printing press. Lenin's views on state fiscal matters were rather traditional, and he theoretically favored maintaining balanced budgets. However, his subordinates in charge of finance did not share his concerns, and Bolshevik fiscal policies made balancing the budget or controlling inflation impossible. In

February 1918, they repudiated all state debts, and afterwards, foreign governments and private lenders refused to offer loans to the new Russian state. They attempted to cover their expenditures through income and property taxes, but these revenues were vastly inadequate. There were some efforts to keep spending under control in early 1918, but such inclinations gave way to unlimited money printing by 1919.[8]

Accurate budgetary figures for this period are difficult to obtain because the Commissariat of Finance did not seem to take its job very seriously. In May 1918, the department could only make the vaguest guess of how much the government was spending and taking in, and their best estimate for expenditures was a figure with a range of 5 billion rubles. In a party meeting during 1919, the Commissar of Finance, Nikolai Krestinskii, implied that his job had no reason to exist, stating "Finance should not exist in a socialistic community and I must, therefore, apologize for speaking on the subject." There were also practical difficulties to calculating the budget. Because the ruble was depreciating so rapidly and irregularly each month, planning yearly budgets ahead of time was impossible. Instead, the Commissariat of Finance published biannual budgets retroactively. According to Katzenellenbaum's older estimates, the deficit percentage of expenditures in 1918 was actually lower than it had been during the previous three years, and the percentages of 1919-1921 were slightly higher than they had been during the Great War years. Newer estimates from R. W. Davies (cited by Malle) are more pessimistic. According to these figures, revenues as a percentage of expenditure never reached higher than 22 percent from the 1918 to 1920, and the true percentage for most of the period may have been in the single digits.[9]

It appears that most of the spending went towards subsidizing the newly nationalized industries and paying their workers, as well as fighting the Civil War. After March 1919, state enterprises received all of their funding for production and wages directly from the budget. Their inputs were covered via the printing press and direct in kind transfers. The Bolsheviks claimed that they had to continue to print money in order to pay peasants for their food, but in fact urban workers and bureaucrats received far more. From 1918 to 1920, farmers received a total of 20 billion rubles, compared to a vastly larger total of 400 billion rubles in wage payments over the same period. Ironically, one of the enterprises employing the most workers was the mint, with 17,361 employees by October 1921. Defense spending was intended to be second to the economic enterprises according to the plan for 1919 but ended up costing more than anything else. After 1920, the Civil War started to wind down and defense spending became less important. Yet even when the Civil War ended, the Bolshevik government continued to run enormous deficits due to the waste and inefficiency of War Communism.[10]

Table 3. Budgetary Figures, 1914-1921

Year	*(In Millions of Rubles)*			*Percent Deficit on Total Expenditure*	*Note Issue*
	Revenue	*Expenditure*	*Deficit*		
1914	2,961	4,859	1,898	39.1	1,283
1915	3,001	11,562	8,561	74.0	2,670
1916	4,345	18,101	13,756	76.0	3,480
1917	5,039	27,607	22,568	81.7	16,403
1918	15,580	46,706	31,126	66.6	33,500
1919	48,959	215,402	166,443	77.3	164,200
1920	159,604	1,215,159	1,055,555	86.9	943,600
1921	4,139,900	26,076,816	21,936,916	84.1	16,375,300

Source: Katzenellenbaum, 69.

The overall result of War Communism and Civil War was a severe collapse in economic output and widespread suffering for most of the population. Gross industrial output fell to less than one-third of 1913 levels by 1921. Out of the total number, output from large-scale industry fell to 21 percent of its pre-war level, and production of many specific items, such as steel, bricks, and sugar, practically ceased. As a result of such anemic economic performance, the living standard of workers, whom the revolution was supposed to benefit, fell to a third of the prewar level. Wages became meaningless as hyperinflation destroyed the ruble, and workers had to rely on meager rations and free services to sustain themselves. The loss of territories that contained important industries and fertile soil were a factor in the economic collapse, but the policies of War Communism also clearly played a role. Lenin ordered the nationalization of all Russian industries in June of 1918, and by the end of 1920, this was virtually accomplished.[11]

Table 4. Output Comparison, 1913 and 1921

	1913	*1921*
Gross output of all industry (index)	100	31
Large Scale industry (index)	100	21
Coal (million tons)	29	9
Oil (million tons)	9.2	3.8
Electricity (billion kilowatts)	2039	520
Pig iron (million tons)	4.2	0.1
Steel (million tons)	4.3	0.2
Bricks (millions)	2.1	0.01
Sugar (million tons)	1.3	0.05
Railway tonnage carried (millions)	132.4	39.4
Agricultural production (index)	100	60
Exports (in 1913 rubles)	1374	208
Imports (in 1913 rubles)	1520	20

Note: Some of the figures above do not refer to strictly comparable territory.

Source: Nove, 68.

Placing industry under direct state control was supposed to raise productivity and output by removing the alleged inefficiencies of capitalism, but the effect was the exact opposite. As nationalization progressed, output, productivity, and the number of employed industrial workers continued to plummet, while illegal private trade on the black market conversely grew. From various estimates, it appears that about two-thirds of the food consumed in Russian cities during the period of War Communism came from the black market. The Bolsheviks made efforts to stop this type of private trade, but there were limits to their power and perhaps even their willingness to use indiscriminate violence. In September 1918, the authorities gave in and started allowing peasants to bring in up to one and a half puds (54 pounds) of grain and sell it freely. Nevertheless, daily caloric intake for Russian workers dropped by 30 percent in 1919 from the 1908-1916 average, from 3,820 calories to 2,680.[12]

Russia's agriculture and peasantry were hurt just as badly by War Communism as industry and the urban population. Whereas peasants had benefitted from the moderate inflation of the First World War by selling their products for higher prices, they now suffered from the Bolshevik hyperinflation. Although a burgeoning black market existed for agricultural products, illicit trade was always dangerous and official government prices always lagged far beyond inflation. The peasants also had the value of savings erased by hyperinflation, a process that was repeated much later when the Soviet Union collapsed. They had accumulated an estimated total of 5 billion rubles in bank savings by the time of the October Revolution, as well as a possible 7-8 billion hidden under mattresses and buried. Although the Bolsheviks did not confiscate small savings accounts when they nationalized banks, they still managed to expropriate their value through the inflation tax. In other words, the Soviet state gained purchasing power by printing money to cover its budget deficits, while the resulting inflation diminished the purchasing power of peasant savings.[13]

However, the most unpopular policy for the peasants was the irregular seizing of farm products known as *prodrazverstka*. The Bolsheviks resorted to this policy because peasants refused to sell their food at official state prices in rapidly depreciating currency. The coercive requisitioning of foodstuffs was greatly resented by the peasants and gave them far less incentive to produce a surplus. This policy, combined with a severe drought, led to the first great Soviet famine. The grain harvest of 1920 was only 54 percent of the average from 1909 to 1913 and the harvest of the following year fell to 43 percent of the pre-war levels. Despite both domestic relief efforts and those of Hoover's American Relief Administration, an estimated 5 million people were killed by the famine of 1921. Violence, chaos, hunger, and misery pervaded Russia and kept getting worse. In 1920, peasant rebellions spread across Russia as fear of harsher requisitions and starvation grew. That fall, the Bolsheviks could only spare 3,000 Red Army soldiers to deal with several thousand revolting partisans in the Tambov region. By February of 1921, Lenin became worried enough about losing the countryside that he began to consider abandoning food requisitions. Finally, the sailors rebellion at Kronstadt the following month convinced the Bolsheviks that they needed to change economic policy or their government would collapse in the midst of inflation and starvation like the two before them.[14]

Discussion

The interesting question is whether the Bolsheviks intentionally created the hyperinflation due to their Marxist ideology, which called for the abolition of money, or simply because printing money was their only available source of finance, as in the case of the other great inflations of the 1920s. Both perspectives have been argued by different authors. Silvana Malle, an economist, suggests that the first Russian hyperinflation was a fairly typical one, in which the government used the printing press to finance its expenditures because it was not able to do so any other way. Several prominent historians of Soviet Russia instead emphasize the role of the Bolshevik ideology and the specific policy choices to which it led. Richard Pipes directly counters views such as Malle's and argues that hyperinflation was the result of deliberate policy measures inspired by Marxist ideology, rather than "responses to desperate needs."[‡] Alec Nove leans towards the perspective of Pipes but points out that circumstances played a role, as well as ideology. Nove cites a passage from R. W. Davies which explains that the Bolsheviks only moved forward with trying to establish a moneyless economy "when it proved impossible to stabilize the currency" and "the abolition of money [seemed] inevitable." Although there is merit to both of these types of views, the more balanced approach of Nove and Davies seems to make the most sense.[15]

The circumstances and economic mechanisms behind Russia's first hyperinflation did mirror those of its neighbors in many ways. As we have seen, the devaluation of the ruble began not after the Bolshevik Revolution, but during the First World War. The Imperial government's military expenditures led to large budget deficits, which it financed by issuing unbacked paper currency after going off of the gold standard. This process was only different from what happened in the other war economies by nature of degree. The Tsar abdicated in the midst of a failing war effort, economic decline, and political unrest. After the first revolution, the Provisional Government took charge of a country in turmoil and only made the situation worse by running bigger deficits and printing more money even faster. After the second revolution, the Bolsheviks did the same. This again was scarcely different from what happened in Austria, Hungary, Germany, and Poland. The consequences of war, destruction, territorial loss, political turmoil, and bad economic policy were enough to cause hyperinflation in all of these countries. Russia suffered from these problems even more than the others and made the typical mistake of financing government budget deficits by printing unbacked paper currency. Thus, it could be said that Russia's first hyperinflation was a fairly typical one caused by predictable economic

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‡ Specifically, Pipes counters Marxist historian E. H. Carr, who somewhat ironically holds the same view on this topic as the pro-market economist Silvana Malle.

factors. However, each instance of hyperinflation is also attached to unique historical circumstances and political choices made by the relevant authorities.[16]

When the Bolsheviks took over, they had to choose whether to save the existing capitalist monetary system in some form or try to create a socialist moneyless system of distribution. According to Marx, money was a source of alienation that would become unnecessary in a socialist economy. The Bolsheviks were also influenced by the German Marxist Rudolf Hilderding, who had argued that it was banks that held all the power in advanced capitalist economies. Thus, the Bolsheviks believed that nationalizing banks should be the top priority and socialist Russia would, at some point, no longer have a use for money. However, Lenin and Trotsky apparently realized that Russia did not have an advanced capitalist economy, and they initially favored keeping the capitalist system under state supervision as an intermediary step in the transition to socialism. The Left Communists, led by Bukharin and Obolenskii (known as Osinskii), refused to accept any compromise with capitalism and instead wanted to immediately move forward towards a planned economy that kept accounts without using money.[17]

The leftist view won out in April 1918 with the decision to move forward with the program that came to be known as War Communism. However, they knew it would still take some time to nationalize all of the country's private industries and create a socialist economy. In the meantime, they continued to use traditional methods of public finance, such as taxation, monetary accounts for state enterprises, and wages for workers. As shown earlier, tax revenue proved to be inadequate to cover government expenditures, so the Bolsheviks resorted to the printing press, like the governments before them had done. When the value of the ruble continued to fall and more of the economy came under state control, the Bolsheviks became convinced that it would soon be possible to establish a moneyless economy. In March 1919, Lenin signed off on a Communist Party program calling for the abolition of money. After this point, the Bolsheviks stopped even caring about ruble expenditures and began focusing on how the budget would work without the use of money.[18]

It was the attempt to create a moneyless economy that caused inflation to skyrocket far above the previous levels it had reached. In May 1919, the Bolsheviks made the crucial decision to allow the People's Bank to print as much money as it felt necessary. As a result, the inflation rate more than doubled, from 598 percent in 1918 to 1,376 percent in 1919, officially turning high inflation into hyperinflation. The following year, the government tried to use a moneyless budget by avoiding cash transactions and funding all state expenditures with direct advances. State enterprises simply delivered materials and rendered services to each other without payment, while workers and many other citizens received housing, transport, and whatever food and goods were available were for free. Money was literally becoming worthless in the Bolshevik economy. By October of 1923, prices had increased by over 648 million times from what they had been in 1913. Preobrazhensky, one of the other Left Communists, was proud of the hyperinflation the Bolsheviks had created, and Osinskii refused to admit that moneyless finance could not work. However, the more moderate Bolsheviks realized by 1921 that such a policy was simply untenable. Undoing what they had wrought was another matter.[19]

As early as 1919, economist and theoretician Ludwig von Mises argued that rational economic calculation is impossible without the use of money.[§] In a market economy, money serves as the common denominator by which people can calculate the values of a myriad of

[§] Mises first presented this argument in a lecture in 1919, responding to a book by Otto Neurath which argued that the German war economy proved that central planning without the use of money was in fact possible. Mises then published an essay based on this argument, titled "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen" or "Economic Calculation in the Socialist Commonwealth." Finally, he developed it into a book in 1922, titled *Die Gemeinwirtschaft: Untersuchungen über den Sozialismus* or *Socialism: An Economic and Sociological Analysis.*

different goods and services. Individuals assign their own subjective values to various commodities they desire, and all try to obtain ones that bring them more satisfaction in exchange for those they consider less valuable. Money serves as the medium of exchange to facilitate these trades by allowing actors to "reduce values to a common unit." Without the use of money, people looking to trade their labor or goods would have to find trade partners who both want what the other has to offer and have what they want in return. For example, a farmer who has a spare horse and wants a plow would have to find someone who has a spare plow and needs a horse. In addition, both parties would have to view this as a fair exchange. In mainstream economics, this is known as the double coincidence of wants problem. Obviously, bartering this way is very time-consuming and inefficient, and it would be far easier to just sell the horse for cash and buy a plow. Thus, without money, trade becomes far more difficult are far less of it occurs. Finally, money can also serve as a store of value or a standard of deferred payment for paying debts if its value remains relatively stable. This allows people to collect savings to use for a later date or make purchases and investments on credit.[20]

The problem with central planning based on in kind resource allocation, as Mises argues, is that economic value can only be calculated if capital goods can be exchanged and all factors of production can be compared using a common unit, i.e. money. Prices and wages serve as signals to producers how to best allocate capital goods, natural resources, and labor in order to achieve the most efficient production methods. In a socialist economy without price signals, the authorities in charge of production have no way to make these calculations. Even if planners know which goods are needed most urgently, they cannot determine the opportunity costs of production. If a single political entity controls every industry, the authorities can transfer capital goods and labor at will, but it is impossible for them to know which moves are necessary.

Without monetary price signals moving up or down, there is no way to adapt to changing conditions and adjust previous economic decisions. The inevitable result is that some industries will end up with too many workers and resources and others will not have enough. An infinite number of possibilities exist for the allocation of capital goods and labor, and it is impossible for any person or group to figure out an efficient combination without the use of monetary calculations. Labor itself cannot serve as the unit of account because the value of different kinds of labor constantly fluctuates based on the final products each worker can create.[21]

Aside from the extenuating circumstances of war and territorial loss, the Bolshevik attempt to establish a moneyless economy explains why output suffered such a severe collapse. As the value of the ruble collapsed, it became increasingly more difficult for people to calculate either present or future transactions. However, even if citizens wanted to trade or make investments, these activities became not only more complicated but illegal. The Bolsheviks intended to be the only actors controlling economic activity, but the system they created made it impossible for them to do so. The millions of people they ruled needed food more than anything, but they also needed housing, transportation, clothes, and numerous other goods. As shown earlier, peasants had no incentive to produce a surplus to would either be exchanged for a worthless sum of cash or simply taken away. The peasants might have been willing to trade their food for industrials goods, but the government had virtually none to give them.

The Bolsheviks were able nationalize virtually all of Russia’s industry, but industrial output suffered decline even worse than the agricultural sector. By late 1919, the Supreme Council of the National Economy (VSNKh or Vesenkha) controlled thousands of enterprises with over a million workers. Bukharin, the leader of the Left Communists, conceived of VSNKh as a single firm that controlled all of these constituent parts, distributed their inputs, and told them which goods to produce, how many, and in what priority. All of these enterprises were supposed to exchange their inputs and output through VSNKh without the use of money as a unit of account. As Mises predicted, the enterprises were baffled as to how to even do this, and the attempt ended in complete failure. Some of the Bolshevik theoreticians discussed ways to establish "labor units" as the common denominator, but they were unable to implement any of these ideas before War Communism ended. By 1921, the Bolshevik leaders realized that it was simply impossible for them to administrate thousands of different enterprises without the use of money. In March, they decided that they needed to change their economic policy and try to stabilize the currency after all.[22]

Stabilization

The failure of War Communism and a moneyless economic system became so obvious that the Bolsheviks were forced to temporarily abandon their attempts to enact Marxist-Leninist principles and allow some market activity. The New Economic Policy (NEP), which began in 1921, established a mixed economy, as a compromise between communism and capitalism. Since NEP made private trade legal again, it required a stable currency in order to work. However, achieving this was easier said than done, and inflation only worsened after the Bolsheviks released price controls. Desperately seeking a stable unit of account, they calculated the 1922 budget in terms of pre-war rubles. Preobrazhensky remarked that this type of currency "was based on the memory of what prices had been 1913." Obviously, this was not a solid enough backing to guarantee the ruble's value. As long as the printing press rapidly churned out rubles, inflation continued.[23]

Much like the preceding hyperinflation, the stabilization that followed came in an orthodox, economically predictable fashion. In July 1922, the Bolsheviks decided to completely change their fiscal policies. They resolved to balance the budget and issue a new currency, known as the *chervonets*, that would be based on the gold standard. The *chervonets* was issued in late 1922 and circulated alongside the paper *sovznak*. The former was in short supply and highly demanded, while the value of the latter fell to almost nothing. Finally, the *chervonets* was established as the only legal currency in February 1924, and *sovznaki* issued in 1923 were exchanged at a ratio of 15,000 to one. In order to keep from having to print more money, the Soviet government balanced its budget in the fiscal year 1923-24 and ran a surplus in 1924-25. This was accomplished by levying several new types of taxes, as well as collecting interest off of both voluntary and coerced savings. In addition, the State Bank became independent again, and a new, more conservative leader was put in charge of the Commissariat of Finance, Grigori Sokolnikov. As it became clear to the population that the Bolsheviks were serious about their change in fiscal policy and commitment to a stable currency, velocity[**] fell drastically and hyperinflation finally ended.[24]

The stabilization of the ruble closely follows Thomas Sargent's theory of "rational expectations" and the examples he describes. Sargent argues that firms and workers are rational to expect high inflation when "the government's current and prospective monetary and fiscal policies warrant those expectations." While isolated actions to combat inflation are not effective in changing expectations, a change in policy regime or long-term strategy can convince the public. Sargent lists common features of how all four of the contemporary Central European inflations were stopped. All four countries balanced their budgets and established independent

[**] Velocity is a measure of the average frequency with which money is spent. High velocity is associated with hyperinflation because people try to spend money as quickly possible before it loses its value. In Russia, velocity was 54.7 in 1922, before falling to 23.2 in 1923 and 13 in 1924.

central banks that refused to grant unsecured credit to their governments. This kept the governments from issuing more debt than they could back with future taxes and from relying on the central banks for their finances. As soon as the public understood that these changes occurred, inflation stopped. Indeed, when the Bolsheviks simply counted their budget in pre-war rubles, this did nothing to stabilize the currency. However, as soon as they balanced the budget, made the central bank independent, and issued a new gold-backed ruble, hyperinflation immediately stopped.[25]

Table 5. The Percentage Rate of Change of the Money Stock, the Price Level, and Output, 1919-27

Year	*Money Stock*	*Prices*	*Total Output*	*Industrial Output*	*Agricultural Output*
1919-20	405	978	-10	-9	-10
1920-21	599	869	-12	10	-20
1921-22	16,420	7,590	47	64	39
1922-23	(monetary reform)		18	28	13
1923-24	128	37	3	22	-9
1924-25	89	-	42	43	41
1925-26	40	11	13	21	6
1926-27	24	-3	1	8	-6

Source: Pickersgill, 1039.

By allowing private trade and creating a stable currency, the New Economic Policy led to tremendous growth in output. When market activity was first legalized in 1921, the economy saw an immediate and substantial recovery, despite the ongoing hyperinflation at the time. The monetary reform of 1922-23 was successful in drastically reducing inflation to 37 percent the following year, however, output growth also declined to a negligible 3 percent.[††] This negative side-effect can be interpreted in two ways. It can either be seen as support for the view that reducing inflation also leads to a significant drop in output, or the Soviet economy simply took

[††] Until 1930, the Soviet fiscal year began in October 1 and ended September 30th.

some time to recover from hyperinflation. The evidence seems to support the latter interpretation. The inflation rate reached its peak in October 1923, and the Soviet budget was first balanced the next fiscal year. The *chervonets* was only established as the sole legal currency in February 1924 and took some time to get out to the peasants in the countryside. In addition, the freedom of contract was further defined in 1924 in a decree that legalized the leasing of land and allowed farmers to hire laborers. As industry and agriculture adjusted to the newly stabilized currency and greater tolerance for market activity, NEP hit its peak in 1924-25, and the fiscal year saw another enormous increase in output. In 1926, Russian industrial and agricultural output finally caught up to pre-war levels.[26]

Most of this increase in growth was from the development of the newly legalized private industry and trade. The government retained control of the "commanding heights" of the economy and state enterprises produced most wholesale goods, while the private sector was allowed to take over small-scale industry and compete with official outlets in retail trade. State industries remained highly inefficient due to excessive overhead costs and low labor productivity, so their final products ended up being more expensive than those produced by private industry. Due to their higher prices, state stores and cooperates could not compete with private traders, known as Nepmen. In the early years of NEP, private trade was responsible for a vast majority of retail sales across Russia, a total of 78 percent in 1922-23. The following fiscal year, the proportion of private retail trade fell to 57.7 percent and then to around 42 percent in the following two years, although the overall volume of private trade continued to increase though 1925-26. After this point, the Soviet government began to clamp down on private trade by depriving the Nepmen of manufactured goods, fuel, and raw materials, and by raising taxes to cut into their profits. The share of private trade declined to 36.9 percent in 1926-27, while the overall volume remained stagnant and began to fall drastically after the next year.[‡‡] As private economic activity ceased to grow, so did the Soviet economy as a whole.[27]

Table 6. Private Turnover during and after NEP, 1922-1930

Year	*Total private turnover (million rubles)*	*Percent of total trade*
1922-23	2680	78
1923-24	-	57.7
1924-25	3300	42.5
1925-26	4963	42.3
1926-27	5063	36.9
1928	3406	22.5
1929	2273	13.6
1930	1043	5.6

Source: Nove, 136; Bandera, 269.

Soviet workers benefitted in many ways from the introduction of private trade and a stabilized currency. In the first years before inflation stopped, the transition to a money economy was tough for workers. The free rations and services that they had grown used to were abolished, and it was difficult for them to live on their tiny wages, which lost their purchasing power rapidly before 1923. Initially, there was labor unrest and strikes, but conditions soon improved when the currency and the economy stabilized. The supply of goods grew with the development of private enterprise, and so did workers' wages, which were negotiated relatively freely during this period. After a low point of only one-third of pre-war levels in 1920-21, wages almost caught up to 1913 levels in real monthly terms by 1925-26. Working conditions also improved due to the enactment of labor regulations and benefits. Such laws were passed first by the Provisional Government and expanded early on by the Bolsheviks, but they meant little during the chaos of war communism and only became reality under NEP. A law from 1922

[‡‡] Alec Nove writes that the overall volume of private trade began to fall in 1926-27, although his statistics seem to indicate that the decline in total private turnover did not begin until the following year.

clarified that work days were limited to eight hours, or even less for heavy labor, and workers received two weeks of paid holidays per year, as well as pay for sickness or unemployment.[28]

Despite the economic recovery, unemployment also became a serious problem under NEP. As enterprises shed the bloated staffs that they had accumulated during war communism, unemployment grew rapidly. Out of a workforce of 8.5 million, which does not include peasants, the number of unemployed during NEP ranged from about 1 to 1.5 million. While the rise of unemployment is usually blamed on the rise of market forces, this interpretation does not seem entirely accurate. It is true that the government started encouraging enterprises to make profits and cut out excess labor, rather than paying too many workers and putting out unaffordable products. At the beginning of NEP, there were simply not enough productive jobs available for all of Russia's urban laborers. Many industries had been destroyed by a decade of war and unsound economic policy, and they needed time to recover. Indeed, the unemployment rate rose rapidly in 1923, while the Bolsheviks were still struggling to defeat hyperinflation, and reached 14.6 percent in January 1924, before the *chervonets* was established as the sole legal tender. When private trade hit its peak in 1925, the rate fell to 11.1 percent. Afterwards, the government began to clamp down on the Nepmen, and unemployment rose to 18.8 percent by the end of the decade. In addition, labor regulations were partly responsible for the high unemployment, especially among young people, who were limited to working six-hours per day and enjoyed other legal privileges which made employers not want to hire them.[29]

Peasant conditions improved even more significantly under NEP. One of the main inspirations for abandonment of war communism in the first place was the spread of peasant rebellions due to the unpopular policy of food requisitions. The was replaced by a fixed tax in kind, or *prodnalog*, in 1921, which let peasants know ahead of time how much they would need to deliver. This had the important effect of changing incentives and getting the peasants to produce more, because they knew they would get to keep all of their produce after the tax quota was reached. After the currency was stabilized in 1924, the tax in kind was replaced by a money tax. The minimal attempts to collectivize agriculture were also abandoned, and the land was left almost entirely in private hands, all the way to the end of NEP. As intended, these policies immediately boosted agricultural production, and by 1925, the total sown area matched the 1913 level. However, the government continued to be the principal buyer of grain from the peasants and offered incredibly low prices, which made them more likely to eat their produce than sell it. In addition, the revolution led to the redistribution of land and with it, fewer landlords and kulaks, large landholders who had been responsible for most grain sales. As a result, despite the recovery of total farm output, both domestic sales and exports of grain remained far below pre-war levels. This was one of main reasons Stalin decided to abandon NEP and collectivize agriculture.[30]

Conclusion

The Bolshevik attempt to do away with money created economic chaos and domestic unrest, which led them to abandon in kind distribution and establish a stable currency. The value of the ruble first started to fall during the First World War, after the Imperial government went off of the gold standard and started printing unbacked paper currency to pay for its military expenditures. Rising food prices benefitted Russia's peasant farmers at the expense of city dwellers, who had to buy their products. The food supply in the capital of Petrograd grew especially dire, and riots led to the abdication of Tsar Nicholas II. The Provisional Government took over, but it continued the war effort and printed money even faster, so food shortages continued. The Bolsheviks then came to power, claiming they could fix the economy and provide food for the population. By that time, the ruble was already in steep decline, and the Bolsheviks had the choice to either try to save it or move forward with establishing a moneyless economy. Initially, they made some efforts to keep the budget balanced by trying to bring it revenue and restrain spending, but these measures were unsuccessful due to a breakdown in the tax system and continuing military expenditures due to the Civil War.

By 1919, the Bolsheviks had nationalized most of Russia's industries and the ruble showed no sign of stabilizing, so they decided it was time to institute centrally planned in kind resource allocation and do away with money. The central bank was given unlimited freedom to print money as it saw fit, and price increases officially moved into hyperinflation territory. Even though the Civil War started to wind down in 1920, industrial and agricultural output continued to plummet due to the Bolshevik policies. Russia was afflicted with a major famine in 1921 and peasants began to revolt out of fear that they would be next to starve. These revolts and the Kronstadt sailors rebellion convinced Lenin that the government had to legalize some market activity and establish a stable currency after all, or else the Bolsheviks would not be able to hold power for much longer. Stabilization finally occurred in 1923, in an economically predictable fashion, when the Soviet government balanced its budget, issued a gold-backed currency, and made the central bank independent again.

[1] Thomas J. Sargent, "The Ends of Four Big Inflations," in *Inflation: Causes and Effects*, ed. Robert E. Hall, (Chicago: University of Chicago Press, 1982), 48-57, 61-65, 70-75, 82-85.

[2] Richard Pipes, *The Russian Revolution*, (New York: Vintage Books, 1991): 79, 191, 234-5; Alec Nove, *An Economic History of the U.S.S.R.*, (London: Allen Lane/The Penguin Press, 1969), 29; S.S. Katzenellenbaum, *Russian Currency and Banking*, (London: P. S. King & Son, 1925), 49-50; Lyndon Moore and Jakub Kaluzny, "Regime Change and Debt Default: The Case of Russia, Austria-Hungary, and the Ottoman Empire Following World War One," *Explorations in Economic History,* Vol. 42 (2005), 246.

[3] Pipes, 234-238, 272-278; Nove, 30.

[4] Katzenellenbaum, 50-53; Roger Pethybridge, "Political Repercussions of the Supply Problem in the Russian Revolution of 1917," *Russian Review*, Vol. 29, No. 4 (Oct. 1970): 398-399, http://www.jstor.org/stable/127295 (accessed May 09, 2012); Pipes, 685.

[5] Pipes, 671-675, 683, 686; Katzenellenbaum, 74.

[6] Nove, 54-55, 60, 63-65, 90; Pipes, 686; Katzenellenbaum, 58, 74-75.

[7] Nove, 55, 74-75.

[8] Katzenellenbaum, 68-70; Pipes, 684-685; Moore and Kaluzny, 246-249; Silvana Malle, *The Economic Organization of War Communism, 1918-1921*, (Cambridge, UK: Cambridge University Press, 2002), 160.

[9] Pipes, 684-685; R. W. Davies, *The Development of the Soviet Budgetary System*, (Cambridge, UK: Cambridge University Press, 1958): 36; Katzenellenbaum, 69; Malle, 168; Nove, 63-64.

[10] Pipes, 683; Katzenellenbaum, 58; Malle, 160, 176-177.

[11] Nove, 65, 68-69, 74-75; Pipes, 681, 712.

[12] Nove, 60-62, 65; Pipes, 695-702.

[13] Pipes, 719, 723.

[14] Nove, 59-62, 66-67, 75, 78, 86; Seth Singleten, "The Tambov Revolt (1920-1921)," *Slavic Review*, Vol. 25, No. 3, (Sep., 1966): 498, 503, 505, http://www.jstor.org/stable/2492859 (accessed May 19, 2012).

[15] Malle, 175; Pipes, 685; Nove, 64-65; Davies, 40, quoted in Nove, 65.

[16] Sargent, 43, 48-49, 56-57, 65, 73.

[17] Pipes, 674, 677-679, 682.

[18] Pipes, 679, 685-686; Davies, 39-41.

[19] Pipes, 686-687; Nove, 64-65.

[20] Jesús Huerta de Soto, *Socialism, Economic Calculation and Entrepreneurship*, (Cheltenham, UK: Edward Elgar Publishing, 2010) 103-104; Ludwig von Mises, *Socialism: An Economic and Sociological Analysis*, trans. J. Kahane, (New Haven, CT: Yale University Press, 1951), 113-115, 118.

[21] Huerta de Soto, 105-106, 115; Mises, *Socialism,* 114-115, 118-122, 130-134; Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth*, trans. S. Adler, (Auburn, AL: Ludwig von Mises Institute, 1990), 11-13, 20-21.

[22] Nove, 65, 68-69, 75, 78; Pipes, 688.

[23] Nove, 86, 90-91.

[24] Nove, 91-92; Joyce E. Pickersgill, "Hyperinflation and Monetary Reform in the Soviet Union: 1921-1926," *Journal of Political Economy*, Vol. 76, No. 5 (Sep.-Oct., 1968): 1044, http://www.jstor.org/stable/1830035 (accessed May 26, 2012).

[25] Sargent, 42, 89.

[26] Pickersgill, 1036; Nove, 92, 94-95, 102; Sargent, 41-42; V. N. Bandera, "The New Economic Policy (NEP) as an Economic System," *Journal of Political Economy*, Vol. 71, No. 3 (Jun. 1963): 267, http://www.jstor.org/stable/1828984 (accessed June 13, 2012).

[27] Nove, 94, 103-105, 136-137; Pickersgill, 1036.

[28] Nove, 113-116.

[29] Nove, 116.

[30] Nove, 85-86, 95, 105-111.

CHAPTER 3

REPRESSED INFLATION AND SHORTAGES

By artificially fixing prices and repressing inflation, the Soviet system of price controls created persistent shortages of food and consumer goods. The price control system was established after Stalin decided to do away with the New Economic Policy in 1928 and remained in place as long as the Soviet Union existed. Before and during the Second World War, the Soviet economy suffered from both open inflation, as official prices in state stores increased a moderate rate every year, but market prices in collective farm markets increased even faster. Both types of inflation were eradicated in 1947 with a currency reform, but only open inflation was conquered for long. For the rest of the post-war era, prices in state stores and co-operatives were strictly controlled and subsidized, so they changed very little until the late 1980s. This caused the economy to suffer from repressed inflation, which can be defined as rising excess demand that leads to excess liquid assets in the hands of the population instead of higher prices.[1] Because production was controlled by political authorities, rising demand did not lead to a greater supply, and shortages were pervasive in the Soviet economy. As a result, the standard of living in the Soviet Union was far below what it was in the West.

Open and Repressed Inflation: 1921-1949

Despite the government's efforts, prices were set mostly by market forces during the early 1920s. In 1921, when NEP began, the Bolsheviks established a Prices Committee under the Commissariat of Finance. This committee was given the authority to set prices for goods sold by state enterprises or purchased by the government from private sources, such as peasants. However, these attempts to control prices were largely ineffective, and traders were usually able to negotiate prices themselves. Inflation was rampant during these years, and it was necessary to change prices frequently in order for them to have any meaning. A majority of retail turnover was private prior to 1924-25, which made it easier to avoid price controls. In 1923, free pricing led to what is known as the "scissors crisis." Whereas peasants previously had favorable terms of trade with the city, this situation reversed itself as industrial prices rose much faster than agricultural. A variety of factors were responsible for this, the most important of which being that Russia's harvests recovered far more quickly than its industrial production.[*] At the peak of the crisis in October 1923, industrial prices were three times higher than agricultural prices, in comparison to 1913.[2]

In response to the "scissors crisis," the Soviet government began to impose stricter price controls on state and cooperative sales. Prices became easier for the government to control as private trade declined and state industry expanded in the latter half of the 1920s. This policy had predictable results that continued for the rest of Soviet history: shortages of consumer goods, long lines in front of stores, selective access to goods, and a gap between official and free prices. The goal of the controls was to lower prices for peasants in the village, but the effect was the opposite. Those who lived in cities, near the factories, were able to purchase goods at the low official prices, and the stores quickly sold out. Private traders would then transport the cheap goods they had just purchased to the villages and sell them at much higher rates, a practice that was derided as speculation. Members of cooperatives and trade unions also had greater access to goods, much as Communist Party members and others with connections later did. According to official statistics, the fiscal year of 1926-27 actually saw slight deflation, and food prices only

[*] Pickersgill's statistics, cited in Chapter 1, seem to indicate that industrial output grew faster than agricultural, but Alec Nove cites figures that show the opposite and explains why this was so. Agriculture recovered quickly as peasant planted and harvested more crops, but industries simply took longer to physically rebuild after years of destruction.

rose by 10.5 percent by 1929. However, these figures do not take into account private food prices, which rose continuously after 1926 and more than doubled by 1929. The disparity for manufactured goods was not quite as significant, but private prices remained higher and rose faster.[3]

Table 7. Comparison of Private and Official Prices, 1926-1929

	(1913 = 100)			
	Food		*Manufactures*	
	Private	*Official*	*Private*	*Official*
1926 (December)	198	181	251	208
1927 (December)	222	175	240	188
1928 (June)	293	184	253	190
1929 (June)	450	200	279	192

Nove, 157.

After NEP ended, the Soviet government introduced a multi-tiered price system with varying degrees of price controls. In 1928-29, rationing of food and consumer good became widespread throughout Russia. According to Alec Nove, this was "perhaps the first and only recorded instance of the *introduction* of rationing in time of peace."[4] Goods were sold at the official ration prices in state stores, which required ration coupons, but other types of stores had other price levels, ranging from controlled to free. Workers were able to purchase some items from special shops that were closed to the public, where prices were higher but the workers were able to get items unavailable elsewhere. Food and manufactured goods were also sold to the working class in other stores for prices that were above rationed levels, but below commercial prices. Other stores, known as *torgsin*, had goods available only in exchange for precious metals or foreign currency, which the state badly needed. Finally, prices freely were set by market forces at peasant bazaars, kolkhoz (collective farm) markets, and black markets.[5]

Unsurprisingly, prices rose much faster where they were influenced by market forces, than in state stores, in which inflationary pressure manifested itself in shortages instead. Artificially low prices led to products selling out quickly and shelves laying barren until the next delivery. In state stores, consumers were expected to take whatever they could find and move on. These problems developed as soon the government was able to effectively enforce price controls and continued, to varying degrees, for the rest of Soviet history. Consumer demand that went unfulfilled in state stores spilled over into the tiny market sector. Because the free sector was so small in comparison to the excess demand created at state stores, market prices often had to be several times higher than official ones, in order for supply and demand to balance. For instance, commercial prices, which were set by the state but close to market rates, were twenty times higher for bread in 1933, six times higher for sugar, and fourteen times higher for sunflower oil.[6]

Although data are somewhat limited, the chart below makes clear that the free prices at collective farm markets were usually much higher than the official prices in state stores in cooperatives. This gap between official and market prices shows that repressed inflation also became a problem very early in Soviet times. Nevertheless, there was also open inflation in state stores during this time, for two reasons. First, wage increases were higher than productivity gains, because enterprise managers tried to hire as many workers as possible in an effort to fulfill overly ambitious plan targets. This led not only to overstaffing but also higher wages as each enterprise tried to offer higher wages in order to lure workers in. Second, investments in heavy industry during the 1930s were much higher than they were for consumer goods. Thus, many workers toiled and received their wages without creating any goods that they could purchase. Again, these problems also existed for most of the Soviet period, but authorities chose to keep inflation repressed in the post-war era.[7]

Table 8. Soviet Price Trends, 1928-1956 (in rubles)

Year	*Basic Industrial Goods (excluding petroleum)*	*Average Annual Wage (Workers)*	*Prices in State and Co-operative Stores*	*Prices in Collective Farm Markets*
1928	100	100	100	100+
1929	98	114	-	-
1930	96	133	-	-
1931	96	160	-	630
1932	97	203 / 226*	200 / 255	3000(max) / 769
1933	100	223	400	1,500-2,000
1934	101	264	-	1,200-1,680
1935	103	323	-	900-1,470
1936	157	406	700	700+
1937	175	432	700	700+
1938	180	493	-	-
1939	201	-	840	-
1940	231	579	1000	1,780
1941	240	-	-	2,220
1942	244	-	-	13,850
1943	246	-	-	31,220
1944	249	822	-	26,335
1945	249	-	2,545	13,575
1946	249	-	3,180	-
1947	249	992	3,895	11,530
1948	249	-	3,235	4,175
1949	669	-	2,770	2,880
1950	556	-	2,215	2,770
1951	551	1,128	2,035	2,810
1952	523	1,140	1,925	3,100
1953	523	1,164	1,740	2,595
1954	523	1,190	1,640	2,855
1955	510	1,204	1,640	2,855
1956	497	1,240	1,640	2,610

*Alternative 1932 figures from Nove, 204, 206.

Source: Holzman, "Soviet Inflationary Pressures," 168-169.

Inflation started getting out of control during the Second World War. Due to the necessary war expenditures, the Soviet government started running its first budget deficits since the stabilization under NEP and was forced to pay for some percentage of these with new currency issues. During the war, strict price controls and subsidies kept inflation in official stores limited. However, collective farm market prices began increasing much faster than they had during the 1930s and reached hyperinflationary levels during the war. After 1944, the government was able to balance its budget again and increase the supply of goods in state stores, so the rate of inflation began to decline from the peak of 1943. Nevertheless, official prices were almost four times higher in 1947 than they had been in 1940, while kolkhoz prices were six and a half times higher than 1940 levels and four times higher than state prices at the time. Thus, the Soviet economy was suffering from both high rates of both open and repressed inflation.[8]

Inflation was wiped out in the Soviet Union with the Currency Reform of 1947. Under this reform, old rubles were mandatorily exchanged for new ones at a 10 to 1 ratio. As Franklyn Holzman argues, there were other ways that the Soviet government could have eliminated repressed inflation, such as higher prices and taxes. However, as in the First World War, higher food prices benefitted the peasants more than other groups, i.e. workers, and left more cash in their hands. Of course, Soviet leaders had always been biased against peasants and wanted to eliminate inflation at the expense of peasants, not workers. Higher prices would have been detrimental to workers, while the currency requisition and reform took purchasing power away from the peasants. The currency reform was indeed successful in getting rid of inflation for the time being. Official prices began to deflate and continued to do so until the mid-1950s. This was largely because productivity began growing faster than wages and nonconsumption expenditures fell, in contrast to the previous two decades. Collective farm market prices also fell for the few years after the reform, but began to separate from official prices again after 1950. Repressed inflation was simply unavoidable as long as price controls remained and continued to plague the Soviet economy until the collapse.[9]

Repressed Inflation: 1949-1985

Since Stalin, Soviet leaders were determined to increase the country's economic growth, but they attempted to do so without paying attention to the laws of economics. The state controlled almost all the means of production, and most economic decisions were made by the authorities. Administrative bodies set target production goals and allocated capital and labor as they considered necessary. Planners aimed to increase output as much as possible and were not concerned with shortages on the consumer market. They distributed currency based on political considerations, without any need to repay it, essentially making money a “free good” to producers. Managers were rewarded for increasing the gross value of their output, which was calculated by adding up the cost of inputs, so they were incredibly wasteful with their resources. Inevitably, the Soviet system created “enormous disproportions, some of which had serious consequences.” Its inefficiency was, however, masked by the country's abundant labor and raw materials.[10]

After decades of rapidly growing output and living standards, the Soviet economy began to slow down around 1970, while supply and demand started to become more unbalanced. Ironically, economic stagnation began during Brezhnev's “gross output drive.” Under this strategy, Soviet planners went back to the old strategy of focusing on rapid growth in heavy industry and defense, while ignoring consumption. The focus on haste and pure quantity, without consideration for the quality of products or consumers’ needs, led to waste, inefficiency, and low growth rates in the long run. The growth of inputs decreased, as resources were used too quickly, capital stock was allowed to age, and workers had no incentive to increase productivity. External factors, such as lower prices for exported materials also played a role. Neglecting research and development led to slow adaptation to new technologies and new products. During the 1970s, the Soviet Union's GNP growth dropped to nearly half of what it was in the 1960s and virtually stagnated by the early 1980s. In addition, a "large and growing gap appeared between the goals of the producer and the needs of the consumer."[11]

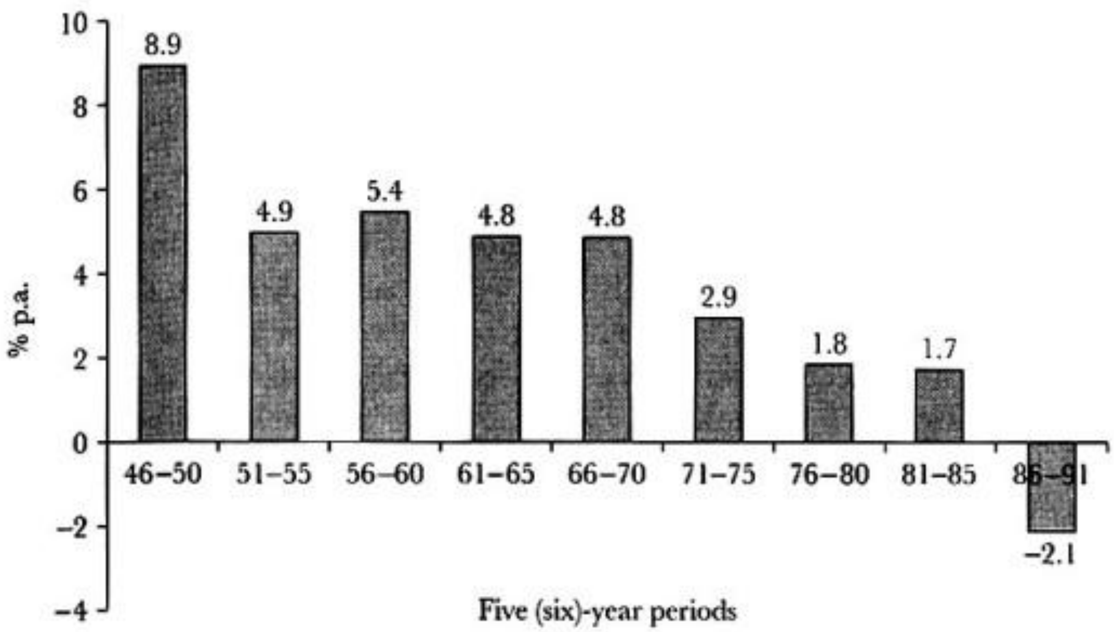

Figure 1. Soviet GNP: average annual growth rates, 1945–91

Source: Hanson, 5.

Because food prices were subsidized and the supply of consumer goods was not increased, many workers saved a portion of their incomes. Ever since raising prices on meat and butter in 1962 led to a riot in Novocherkassk, the authorities tried to avoid raising prices on basic food items. In 1965, Brezhnev's chief economic minister Kosygin introduced a reform that included retail price subsidies for basic foods, in order to keep their prices stable. Workers' wages, however, did not stay stable. In a centrally planned economy, the production sector is not supposed to be part of the monetary economy. The Soviet state bank provided enterprises with credits needed for inputs, and balances remaining in accounts were wiped at the end of each year. However, the production center still contributed to monetary expansion through wage payments. Yet with food prices subsidized and shortages on the consumer market, workers chose to save part of their income.[12]

Although many authors assume that the savings were forced, Peter Boettke argues that individuals chose to save their incomes voluntarily, with the expectation that goods would be available later. Interviews with Russians who lived through the Soviet times confirm this argument. "People save in order to consume later," write Birman and Clarke, "so savings in general can be defined as delayed demand for consumer goods."[13] While some did save up thousands of rubles during the course of their life, it was done in the hopes of buying a car later or simply as a rainy day fund. Although the selection in stores was indeed bland and meager, some Russians spent their extra income on vacations or new appliances and did not amass any significant savings. Domenico Nuti has also claimed that the population could spend any extra income in the small free sector that continued to exist in the collective farms and black markets. Although this may have been true to some extent, Russians who were interviewed did not consider these sales very significant.[14]

Since the 1970s, workers almost continuously earned more money than they spent and savings continued to grow. In the second half of the 1980s, the gap between income and spending became much larger. As a result, the percentage of income put into savings also grew. In 1980, the population saved 4.1 percent of their wages and the number continued to grow throughout the decade, reaching 13 percent by the first quarter of 1991. As demand grew from increased savings, supply did not increase accordingly, and the result was more shortages and longer lines. The increase in demand should have caused prices to increase, but because prices were fixed, it instead led to repressed inflation. According to Byung-Yeon Kim, the proportion of forced savings of the total increased from 9 percent in 1965 to 42 percent in 1989. It is possible that the savings truly did become in voluntary in the late 1980s as wages were increased far more rapidly than they had been before, but shortages became even worse. Whether Soviet savings were forced or voluntary, savings by Soviet citizens served no productive purpose. Rather than financing investment, as savings would in a market economy, and simply languished in bank accounts.[15]

The growing accumulation of savings became "monetary overhang," in economic terms, and caused a drastic increase in the Soviet money supply. The government had tried to control both consumer demand and cash holdings, but lost control over both, as a result of the 1965 reform. Producers used cash only to pay their employees, so the primary constituent of money supply was cash held by the population, including savings bank deposits and state bonds. According to Birman and Clarke, only 15-30 billion rubles were needed for cash circulation in 1985, yet the actual money supply at that time was over 200 billion rubles. By their estimates, the total money supply was an astonishing seven to ten times what was needed for regular use. The population was overpaid in relation to how few consumer items were available to buy. They became increasingly frustrated at shortages and long lines. The state could no longer increase labor productivity, its "most pressing objective," because additional money was no longer an incentive to work harder. Consumer demand vastly exceeded supply, and the Soviet economy moved further from equilibrium.[16]

Effects

Communism simply failed to provide the high standard of living that it promised to ordinary people and never came close to matching the relative prosperity of the West. Per capita income in the Soviet Union peaked at just over one-third of United States levels, yet even this number overestimates their well-being. After all, increasing yearly output, as measured in macroeconomic statistics, does not necessarily correlate with improving conditions for the masses. This is true even for market economies, but statistics and reality were even farther apart in the command system. Both in the Five-Year-Plans and their subsequent implementation, Soviet officials prioritized allocation of resources towards defense and heavy industry over consumer goods. As Philip Hanson puts it, "If steel, say, was in shorter supply than originally planned, it was the production of bicycles that would lose out, not that of tanks or machine-tools."[17] Estimates show that in the 1980s, about 50-55 percent of Soviet GNP went towards consumption and anywhere from 10 to 25 percent to the military, compared to 65 percent and 7 percent in the United States, respectively. Agricultural production accounted for about 30 percent of Soviet GDP, as opposed to only around 2 percent in the United States, but the Soviet collective farms were notoriously inefficient. These factors created never-ending shortages of food and consumer goods, which often meant that even if workers had money to spend, there was nothing worthwhile available for them to purchase.[18]

The results of the central planners' priorities were telling. The Soviet military was long considered to be on par with that of the United States, with its much larger economy. The trade-off was dismal conditions for consumers. On average, Americans and Soviets ate almost the same amount of calories per day (3300 and 3380), but the comparison ends there. A commonly used indicator of consumer living standards is the proportion of their incomes that goes to food costs. In the mid-1980s, the average Soviet spent 59 percent of his or her monthly income on food, versus only 15.2 percent for average Americans. This was even worse than in 1927, when

Soviet workers spent 43.8 of their income on food. The quality of Soviet diets was also much poorer. Bread and potatoes made up 46 percent of daily caloric intake, while meat and fish only accounted for 8 percent, if lard and by-products are not included. For the United States, these numbers were 22 and 20 percent, respectively. Amazingly, per capita meat consumption for the Russian/Soviet Empire was actually lower in 1985 than it was in 1913, falling from 88 kilograms annually to 62 kilograms. Fresh fruit and vegetables were only available during harvest time in the Soviet Union, and almost non-existent otherwise. Indeed, Philip Hanson states that bread, potatoes, and vodka were the only food products that were not usually in shortage.[19]

Other basic indicators of living standards, such as housing and clothing, were no better than the food supply. Lenin had once declared that each person should get 9 square meters of housing space, and indeed, by 1989, the median allotment was estimated between 9 and 12 square meters. The corresponding figure the United States was 55.3 square meters per person. Getting an apartment at all was usually difficult, and people had to often wait for years before one was allocated to them. Soviet consumption of textile products per person was 30 percent of U.S. levels and a 97.6 percent for shoes.[20] Although clothes and shoes were usually available in Russian stores, the selection was usually very poor. Clothing stores generally had racks of identically styled items, with perhaps two color variations. The selection of shoes was also poor, and some people called Soviet shoes "wooden" because they were uncomfortable. However, others argue that Soviet shoes were better quality and lasted longer than the cheap off-brand shoes available in the former Soviet Union today.[21]

One of the major weaknesses of the Soviet economy was a lag in acquiring new technologies and new products, and this was reflected in the population. Soviet housing was not only smaller, but also of lower quality than in the United States. Figures from 1986 show that 80 percent of American homes had central heating, 75 percent were connected to sewers, and 59 percent were air-conditioned. In the Soviet Union, most apartments were heated by old-fashioned radiators, hot water was often unavailable, and air conditioning unheard-of. While 90 percent of American households had telephones, a meager 10-12 percent did in the Soviet Union, and even these were often on shared lines with neighbors.[†] Overall Soviet consumption of durable goods was 14 percent of the United States level. Washing and drying machines remained rare, and many Soviets continued to wash their clothes by hand and dry them on clotheslines. Televisions were as ubiquitous as in the United States, although the quality was lower, and black and white sets were not uncommon. On the other hand, the Soviet Union had only 200,000 computers in 1987, compared to 25 million in the United States. Another of the greatest disparities was in the availability of cars, which stood around 7 percent of the U.S. levels in 1988, 55 cars for every 1000 people compared to 771 per 1000.[22]

Table 9. USSR: Household Access to Utilities and Other Amenities, 1989 (in percent)

	State	*Private*
Central heating	85	12
Water supply	87	21
Sewage	84	11
Hot water	69	3
Gas stove	81	75
Electric stove	14	1
Bathroom or shower	77	8
Telephone	37	12

Source: IMF, 340.

Finally, the best indicator of Soviet living standards may be the state of health and

[†] I can still remember from when I was very young, my family had a neighbor named Lyuba who liked to talk on the phone for long periods of time and often tied up the shared phone line. However, I was shocked to now learn that only 1 in 10 families even had a telephone and had to verify this statistic across three sources.

medical services. Medical care was guaranteed to the entire Soviet population and provided for free, but the quality was incredibly poor. Shortages extended even to hospitals and contributed to alarming health problems in the Soviet Union. In the late 1980s, one out of six hospitals lacked running water entirely, and about 30 percent were not connected to sewer lines. In 1988, the USSR minister of health estimated that, overall, there were seven to ten times fewer facilities per hospital bed than in the United States.[‡] Pharmacies were likewise affected by shortages, and it was often difficult for people to get their necessary medicines. Of course, health care in the United States was vastly more expensive, yet American consumption of medical services was still three times higher.[23]

Another major source of health problems for Soviets was pollution in the environment. In the worst areas, health risks from pollution were estimated to be 10 to 100 times than acceptable levels in the West. For most of the Soviet era, environmental concerns were largely ignored, and the first official data on the state of the environment and associated health effects was not published until 1988. Many industries used old and inefficient machinery, and 38 percent of emission sources were not even equipped for pollution control. As a result, it has been estimated that air pollutant levels in Soviet cities were from 10 to 50 times higher than in Germany or France. Due to air pollution (and most likely, nearly ubiquitous smoking habits), rates of death from respiratory illnesses were 2.8 times higher for men and 1.7 times higher for women than in several Western countries. Improper waste disposal and the lack of sewer systems led to poor water quality and disease outbreaks. Municipal water was not adequately purified, and many Soviets continued to drink from wells and natural flowing water, which could often become contaminated. Poor water quality led to 900,000 cases of hepatitis per years, sixteen times higher than the United States. Soviet farms continued to use the notorious

[‡] It is unclear from the source which specific facilities the minister of health had in mind.

pesticide DDT 20 years after it was banned in the West, and 10 percent of Soviet food samples were found to be unsafe for human consumption. The nuclear disaster at Chernobyl in 1986 was a watershed moment that caused great concern for the environment and anger at the government's mishandling of it.[24]

A few statistics on life and death illustrate where the overall health situation stood in the Soviet Union. Cancer rates for males were 1.5 times higher than in the West, although women fared better with a comparative ratio of 1.04. In 1985, the Soviet infant mortality rate was 25.1 deaths in the first year per 1,000 births, significantly higher than the United States at 10.4 and even East Germany at 9.2.[25] However, many would-be infants never even had a chance. As with other consumer goods and pharmaceuticals, contraceptives were either unavailable or of low quality. On the other hand, abortion was easily available and free under the Soviet medical system, so it became the primary method of birth control. The average Soviet woman had about two abortions during her childbearing years, but it was not uncommon to have more than five, or even upwards of ten.[26] Soviet life expectancies increased by an impressive 20 years during the Stalin era, but then they actually started dropping after hitting a peak in the early 1970s. The

Table 10. Average Life Expectancy at Birth in the Soviet Union (in years)

Year	*Total Population*	*Men*	*Women*
1938-39	46.9	44.0	49.7
1955-56	67	63	69
1958-59	68.9	64.4	71.7
1971-72	69.5	64.5	73.6
1978-79	67.9	62.5	72.6
1983-84	67.9	62.6	72.8
1984	67.7	62.4	72.6
1985	68.4	63.3	72.9
1986	69.6	65.0	73.6

Source: Ryan, 1513.

average for men fell by two years, from 64.5 to 62.5 and for women by one year, from 73.6 to 72.6. Only in 1985 did the numbers begin to grow again. By contrast, U.S. life expectancies were slightly higher in 1972 and continued to grow steadily ever since, from 67.4 and 75.1 in 1972 to 71.1 and 78.2 in 1984.[27]

Discussion

In the former Soviet Union, people now face high unemployment and long for the guaranteed jobs that existed under communism, yet this practice was responsible for many of the aforementioned economic woes. Unemployment was virtually non-existent in the Soviet Union until the Gorbachev era because excess demand for labor was intrinsic to the system. Soviet laws made it difficult to fire workers, but firms rarely even wanted to do so. Due to high output targets and shortages of resources, enterprises tried to compensate by hiring as many workers as possible. This ensured a certain level of comfort for the workers, but it did little to increase their material prosperity. Soviet labor was inefficient and misallocated, which is why shortages prevailed for most products and there was little for workers to buy. Low labor productivity became one of the major problems of the Soviet economy in the post-war era. The threat of repression under Stalin went a long way towards ensuring plan discipline, but the liberalization that began under Khrushchev caused discipline to soften. This left Soviet workers with neither carrot nor stick to motivate them. If they did not work hard, it was unlikely they would get fired or punished. If they did work hard, they were unlikely to be rewarded with better pay, and even if they were, there was not much available to purchase with it.[§] Ironically, the situation would not have improved much even if Soviet workers had exerted more effort. Some enterprises employed too many workers, other did not have enough, and there was no guarantee that any of

[§] The well-known Soviet cliché was "We pretend to work, and you pretend to pay us."

them were producing goods that were valuable to consumers.[28]

Communism was supposed to serve the needs of workers, but the Soviet system was not structurally capable of doing so. After all, when workers go to spend their paychecks they become consumers. In a free market, competing firms decide which goods to produce, their amounts, and their prices based on signals from consumers. Of course, this process is the antithesis of communism. In the early days, the Bolsheviks attempted to establish a moneyless system where the state rationed out everything in kind directly to workers. This experiment failed and they were forced to acquiesce to commodity production and wage labor. After the brief interlude of the New Economic Policy ended in 1928, the Soviet state essentially became a monopoly corporation responsible for paying and producing everything for its citizens. Workers were still paid money wages and used these for whatever they were willing and able to purchase, just as in a capitalist system. The primary difference was that instead of independent businesses competing with each other for consumers' money, every Soviet firm was part of a single hierarchy in which central planners made all of the decisions about production. The General Secretary was ultimately responsible for all decisions, while the Politburo and lower ministries designed the plans and passed them on to the enterprises, farms, etc. Thus, producers were only beholden to the planners above them and were not responsive to the wishes of consumers. The planners had no particular reason to care about public well-being and could ignore growing consumer demand, so the consumer market remained in a perpetual state of shortage even as total output was growing.[29]

To varying degrees, shortages plagued the Soviet consumer market from the time of the revolution all the way to the collapse. Under Lenin and Stalin, the Soviet Union experienced three major famines, two hyperinflations, and little material improvement for consumers. The

Soviet people hoped that Stalin would finally relax his repressive policies after the war and focus on improving the lives of workers, as the official ideology dictated. Instead, many of those liberated from Nazi-occupied lands were sent off to gulags, and the Soviet Union was afflicted with its third famine. After Stalin's death, Khrushchev shifted investment priorities towards consumption and agriculture, which did improve per capita consumption and caused inequality to decrease. There were no more chaotic upheavals or mass starvations, but shelves were often empty, queues could be long, and the quality of products was poor. Consumption continued to grow under Brezhnev, yet incomes grew faster than the supply of goods, so shortages persisted. Midway through Brezhnev's tenure, even the official GNP growth rates slowed down, and the Soviet Union ceased to be catching up with the United States after 1973. By Gorbachev's time, the economy had almost completely stagnated, and he felt that perestroika was necessary to get the economy growing again and improve conditions for its citizens.[30]

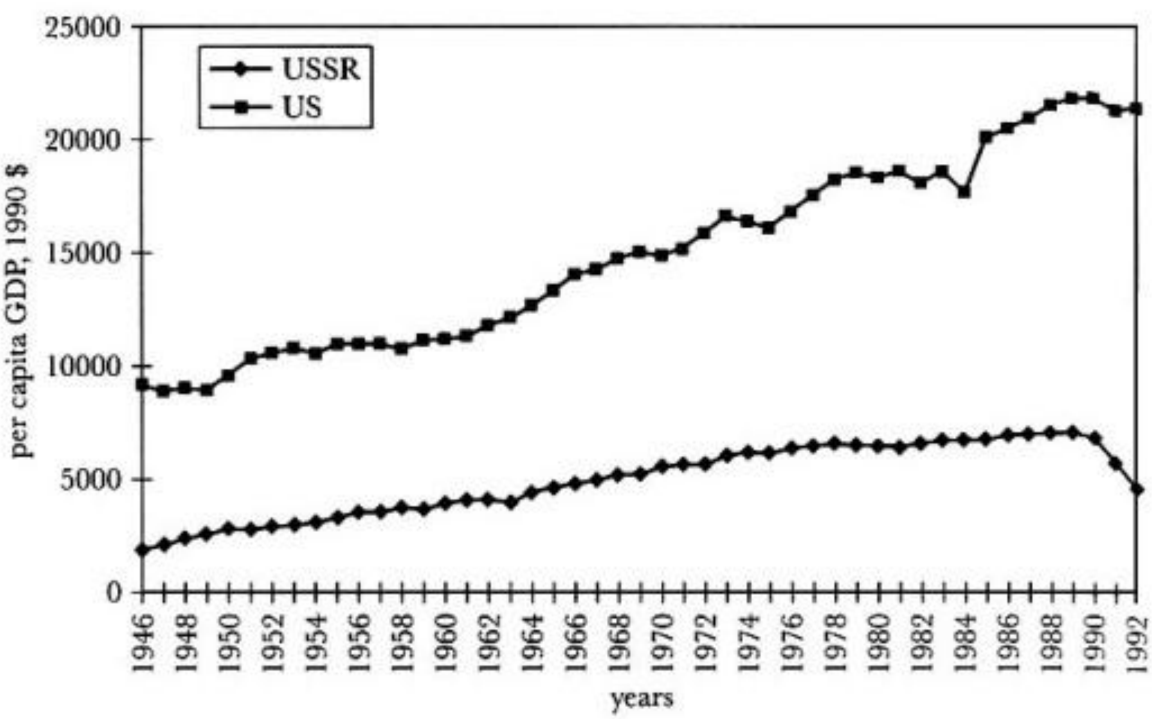

Figure 2. Catching up overtaking: USSR and US per capita GDP, 1946–92

Source: Hanson, 244.

Conclusion

Price controls led to repressed inflation and never-ending shortages in the Soviet economy. The Soviet government first instituted price controls in the late 1920s, and the results were usually the same ever since. State stores and co-operates that sold goods at official prices usually had shortages, and consumers were unable to find the products they wanted. However, even the official stores continued to have open inflation until the end of the Second World War, due to excess wage payments and production plans that ignored consumer goods. In 1947, a currency reform eliminated both open and repressed inflation and temporarily reversed the previous inflationary pressures. However, wages again began to be increased more than productivity gains, and central planners resuming ignoring consumer needs. As repressed inflation increased, shortages became pervasive and workers saved more of their incomes. Many items that were ubiquitous in the West were virtually unavailable in the Soviet Union, and the standard of living in general was much lower.

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[4] Nove, 156-157.

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[15] *Ekonomika i* Zhizn', 1991, No. 6, p. 16, No. 24, p. 9; Birman and Clarke, 495-6; Kim, 106, 111.

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CHAPTER 4

RUSSIA'S SECOND HYPERINFLATION

Mikhail Gorbachev's economic reforms of the late 1980s, known as perestroika, and the hyperinflation that followed in the early 1990s were traumatic events for former Soviet citizens and contributed to a growing skepticism about the desirability of a free markets and democracy. Initially, much of the Soviet population supported perestroika and hoped that it would solve communism's problems, such as persistent shortages and general poverty compared to the West. Indeed, Gorbachev's reforms were intended to increase economic growth and improve the supply of consumer goods, but the results were the exact opposite. Inflation and declining output made shortages even more acute, and the Soviet public suffered even more than they had during the previous decades of communism. Hyperinflation also caused real incomes to drop, wiped out life savings, and made food very difficult to find. Although it was caused by the legacy of communism, hyperinflation occurred during the first several years of capitalism and democracy, creating a negative first impression of these social systems. These years, the early 1990s, brought prosperity only to the very few, while the vast majority experienced poverty, chaos, and immense hardship. This has led many of inflation's victims to desire stability, even if it means a partial return to authoritarian politics and a managed economy.

Perestroika

By the time Gorbachev came to power, most Soviet citizens agreed that the economy had problems and needed some sort of change in order to improve. They could see that labor often went to waste, the supply of goods had hardly changed in many years, and there was little visible improvement in little standards.[1] While this was apparent to the general populace, Gorbachev was the first Soviet leader to publicly admit that central planning was not working and suggest trying something different. Almost immediately after becoming General Secretary, Gorbachev began to speak about the need to improve the supply of consumer goods and agricultural products. The previous leaders that followed Stalin had also made some efforts to improve agriculture and consumption, but Gorbachev could see that these efforts had been largely insufficient. He was more honest about the depth of the problems than his predecessors had been and placed greater emphasis on the need for change. Gorbachev argued that the economy was wasteful and inefficient, and if it continued along the same track, the promise of socialism would never be fulfilled. The economy had been virtually stagnant for over a decade and was falling further behind the West, so Gorbachev feared that simply maintaining the status quo could lead to the Soviet Union facing worker revolts, as Poland had in 1980, and losing its superpower status.[2]

Soviet citizens already knew that the economy was in bad shape, but they hoped that Gorbachev's frank assessment of the situation and commitment to fixing it would bring real improvement. Before Gorbachev, the Soviet government was not exactly known for its honesty in reporting the shortcomings of communism and tried to censor any information that did so. Nevertheless, shortages were obvious for Soviet consumers and were the subject of the famously cynical Soviet political humor. Earlier in the post-war era, people living in the Soviet Union at least saw gradual improvement every year, but since the Era of Stagnation began around 1975, it was difficult to even have hope for the future. When Gorbachev admitted that the economy was failing and needed restructuring, they were more surprised by their leader's honesty than his message. Few still believed in the lofty visions of communism that had been promised by Marx and Lenin, but many did accept the notion that Gorbachev could at least improve their society, including the supply of goods and services. A Soviet sociologist reported that between 35 and 43 percent of the population supported perestroika from 1985 to 1987, while a poll by two major American news agencies found a much higher 73 percent in favor in 1988.[3]

After raising hopes for significant positive change, Gorbachev's actual reforms managed to be both timid and deleterious. In the early years of perestroika, Gorbachev did not have a specific strategy in mind, and his early measures were quite traditional. In an effort to improve labor discipline and raise productivity, Gorbachev tried to drastically restrict the production and consumption of alcohol. Like many of his measures, the anti-alcohol campaign had good intentions and reasons behind it but turned out to be highly unpopular and ineffective. The Russian imperial government had attempted a similar policy during the First World War, and the results were the same in both cases: budget deficits increased due to a loss of sales tax revenue, while Russians continued to drink homemade moonshine, known as *samogon*. Gorbachev's second early policy was *uskorenie,* or acceleration, which raised investment spending on new technologies to try to accelerate growth. In practice, much of this new investment went into the defense sector, while the priority of agriculture and consumption was downgraded to compensate. Obviously, this did little to benefit consumers and it also failed to increase overall growth. Meanwhile, both of these policies contributed to growing budget deficits, which were one of the main causes of inflation.[4]

The reforms of the middle period (1987-1988) initiated the growth of inflation and the collapse of the command economy. Gorbachev and other top officials were still not ready to consider creating markets or private property, but they took some measures to decentralize decision making, legalize unplanned activity, and increase trade with the world. However, these halfway measures only created more problems. They relaxed some of the central controls over the economy, but in such a way that caused the breakdown of the socialist system without replacing it with a functioning market. The most important reform in this period was the law on state enterprises, passed in 1987. The intent of the law was to make enterprises responsible for their own management and finances, but in practice, the central government continued to both control many of their decisions and subsidize their accounts. Thus, the reform did nothing to address the old problems of shortages and soft budget constraints. Enterprises did get more freedom over their decisions, but this did more harm than good because they continued to get bailed out when they ran losses.[5]

Decentralization gave enterprises more power to determine production plans, wages, and prices, and it allowed them to shift balances from input accounts that were previously eliminated annually. This essentially monetized the production sector, whose contributions to the money supply were previously limited to just wage payments. Under these conditions, competition and efficiency did not improve. Since their inputs remained free, enterprises tended to raise wages more than was justified by additional production, "contrary to declared government policy." This was also an old problem, but Gorbachev's reforms only made it worse. Enterprises were able to increase profits simply by increasing prices within set limits. However, due to the nature of the system, some of these price increases were ultimately paid for by the state, which further contributed to monetary expansion. Since wages and prices were both increased without an accompanying increase in production, this only created inflation without alleviating shortages.[6] Finally, Gorbachev's reform also created greater shortages by allowing enterprises to "siphon" goods off the consumer market with their spare funds.[7]

Another important law from the middle period was the law on cooperatives from 1988, which essentially legalized private enterprise within certain parameters. The existing state enterprises and newly legalized cooperatives and banks were given just enough freedom to act outside of the planned system, but not enough to do so in a way that was economically healthy. The cooperatives and banks were essentially private companies, but in practice, they were often connected to state enterprises. The inputs for enterprises were still financed by the state, but their managers were able to move these funds through the less regulated banks and cooperatives to accumulate personal profit. For instance, an enterprise could get easy credit from an affiliated bank and use it to pay a family member's cooperative for bogus services; or they could sell state-provided goods to the cooperative at the low official price, and the cooperative was then free to raise prices and resell the goods. The involved parties would share the profits, which came at the expense of the state budget.[8]

During Gorbachev's tenure, state budget deficits spiraled out of control and were financed largely by monetary emissions. The state budget had always played a huge role in the Soviet economy and was responsible for distributing about 60 percent of national income. Budgets started growing since the early 1970s, and many sources suggest that deficits probably existed even earlier, although official Soviet records only admit deficits after 1985. Since 1968, the State Bank covered budget deficits with credits, which were never paid off. Instead, the bank covered the shortfall by printing new rubles, which contributed created inflationary pressure. However, as Gur Ofer shows, deficits only became a serious problem after Gorbachev's reforms. In the early 1980s, the budget deficit was a manageable 2 percent of GDP, but by 1989, it had grown to about 11 percent. By the end of 1991, the Soviet budget deficit had reached an estimated 20 percent. Likewise, the amount of money printed to cover the deficit rose sharply after 1985. However, since prices remained controlled, most of the new money printed simply accumulated in bank accounts and did not create much open inflation. From 1987 to 1991, total bank deposits remained about 7 or 8 times higher than money in circulation, an excess known as monetary overhang.[9]

Table 11. Indicators of Money Supply and Overhang, 1987-1991
(in billions of rubles as of January 1st, except where noted)

Year	*Money in Circulation (a)*	*Total Bank Deposits (b)*	*Overhang Indicator (b/a)*
1987	74.8	593.2	7.93
1988	80.6	631.6	7.83
1989	91.6	702.6	7.67
1990	109.5	781.2	7.13
1991	136.1	944.6	6.94
July 1, 1991	157.6	1325.5	8.41

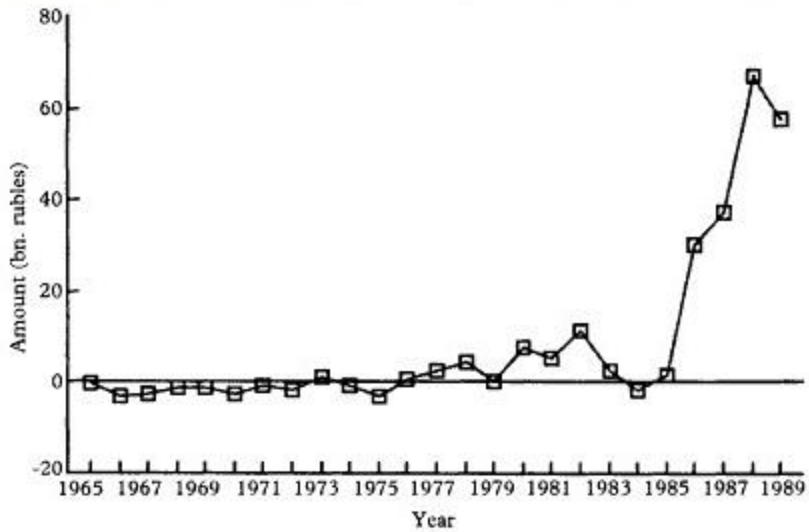
Source: Filatochev and Bradshaw, 742.

Several factors combined to cause the growing deficits during the Gorbachev years. Total revenue fell from reduced production and efficiency. Gorbachev's anti-alcohol campaign failed to produce the desired increase in productivity, while cutting alcohol's share of budget revenue from 12-14 percent down to 3.5 percent. As far as external factors, the fall of oil prices and production in the mid-1980s caused export revenue to decline. After 1987, the state cut spending on investment from about 20 percent of GNP to 13 percent, but the accompanying decline in revenue from profit taxes nearly canceled out the budget cut. According to official figures, defense spending fell from about 9 percent of GNP in the 1980s to 7.5 percent in 1990. Other estimates, such as that of Philip Hanson, put the share of defense spending in GNP as high as 17 percent, although they also agreed that the percentage was shrinking. Social welfare spending, however, increased slightly from 14 percent, a major part of which was price subsidies.[10]

Retail price subsidies were a major cause of the Soviet budget deficit and repressed inflation. The government maintained the retail subsidies instituted in 1965, and food prices remained almost unchanged by the late 1980s. As a result, the share of the true price paid by consumers continuously declined, from 50-80 percent in 1970 to 25-40 percent in the late 1980s. The remainder of the price was paid by the state, so the portion of the budget spent on subsidies went from 4 percent to 20 percent in the late 1980s. This amounted to 11-15 percent of total national income. The effects of continuing budget subsidies mounted: savings accumulated, shortages continued, market disequilibrium worsened, and the budget deficit increased. After stabilizing at around 4 percent in the 1970s and early 1980s, the deficit accounted for 10 percent of the budget in the middle of the decade and reached 18-19 percent by 1988-9. Although several other aforementioned factors contributed to the deficit as well, Byung-Yeon Kim argues that "one of the most important was subsidy expenditure." The policy was also partly responsible for the decline in revenue, since more taxes on turnover and profits would have been collected from higher priced goods.[11]

In light of price subsidies and other factors, internal and external, the Soviet budget situation became dire in the late 1980s. Because the state used more of its resources for consumption, less of the budget went toward investment and the creation of new wealth, which was supposed to be one of its main functions according to the central planning model. Whereas expenditure on investment stood at 10.3 percent of the GDP and subsidies at 5.8 percent from 1971-75, these respectively halved and doubled to 5.3 percent for investment and 12 percent for subsidies in the 1990 plan.[12] This caused economic growth to slow and taxable activity to decline. As state revenue failed to even finance its own consumption, "the Soviet system almost ceased to function after 1988." Thus, price subsidies had hurt the economy not only by adding to budget expenditure, but also by indirectly decreasing revenue. The destabilization of the consumer market and the rate of repressed inflation also accelerated, because the amount of money printed to cover the deficit soared after 1985. Buyng-Yeon Kim concludes, the "sharp increase in printing money in the late 1980s suggests that the Soviet economy was then on the verge of collapse."[13]

Figure 3. *Amount of deficit financed by printing money*



Source: Kim, 121.

Inflation and Collapse

Inflation began to spiral out of control in the early 1990s as the government started raising both prices and wages. The cause of the shortages to begin with was that consumer purchasing power was higher than the supply of goods. In a market economy, rising demand leads to price increases and a greater quantity of goods being sold. In the Soviet Union, prices remained fixed for most of the post-war era, even as the population and their wages grew. This should have led to price increases, but instead the inflation was repressed, so store shelves remained empty, while workers' savings grew. Freeing prices would have allowed the consumer market to balance, albeit by causing open inflation. The Soviet leaders knew that prices were too low but felt that simply releasing controls would be politically dangerous. Their preferred approach was to raise prices by fiat rather than letting them be set by market pressures. However, they felt that it was necessary to compensate for the increases by also raising wages and pensions. This policy made good sense politically, but the results were economically disastrous. Since both incomes and prices increased, there was no incentive for producers to increase their output and shortages persisted. Moreover, price increases went into effect first, while the compensation that was promised often took longer to arrive. This left many people simultaneously facing shortages, inflation, *and* lower real incomes.[14]

Instead of alleviating the shortages, Gorbachev's policies made them intolerable. As described previously, shortages were a result of central planning and were already a major nuisance long before Gorbachev came to power and started tinkering with the system. The great irony was that he correctly identified this problem, but his attempted solutions made it so much worse. In 1989, the supply of consumer goods was no longer just growing slower than workers' incomes but actually lower than the previous year in absolute terms. Production of numerous durable goods, including furniture and various home appliances, fell far short of the planned goals. As domestic production fell, imports of consumer goods were also reduced by 9 billion rubles between 1986 and 1988. By 1991, only twenty out of 1,100 categories of consumer goods were "routinely available." The most alarming new shortages reported were of soap, laundry powder, and toothpaste.[15]

In the case of the food supply, the collective farms had always been inefficient, and much of their product rotted before it made it to store shelves due to problems with collection, storage, and transportation. This issue was exacerbated by perestroika. Soviet harvests relied largely on the extra labor of urban workers and professionals being sent out from enterprises to help collect the crop at the appropriate time. This practice was unpopular but necessary in the context of the

Soviet system. After Gorbachev loosened the grip of central control, enterprises began refusing to send their workers out to the fields, and the harvest suffered as a result. Agricultural authorities then retaliated by refusing to send whatever crops they did collect to the cities that failed to help with the harvest. This type of selfish behavior became part of a general pattern in the Gorbachev era.[16]

As shortages worsened and the command hierarchy fell apart, the political and economic components of the Soviet Union became antagonistic towards each other and ceased to function effectively as a unit. From individuals to republics, everyone started trying to look out for their own and hoarding whatever food, goods, and cash they could find. While shortages had always existed, hoarding was a new development. Previously, people at least felt comfortable that a minimum supply of food would always be there, even if the selection was poor or they had to wait in line. With perestroika, they were no longer sure that stores would have food in the near future, and if they did, the prices would probably be higher by then. People also hoarded consumer goods, either to save for personal future use or in an effort to buy anything available and resell it for profit.[17]

Public hoarding was even more extensive than hoarding by individuals. Republics, cities, enterprises, and other groups tried to take care of their own constituents by turning to protectionist policies, but this instead only exacerbated the situation for everyone. Enterprises started refusing to fulfill contracts to deliver necessary inputs to others producers, which obviously hampered their output. In 1989, the Moscow city government ordered stores to start checking passports and only allow residents of Moscow or the surrounding oblast to purchase food. In retaliation, surrounding cities stopped delivering supplies to Moscow and started using their own rationing systems. Rationing spread to Leningrad and other cities across Russia in

1990. Perhaps most damaging to the Soviet Union as a whole was the introduction of protectionist policies by the member republics. In late 1990, Ukraine completely stopped exporting agricultural products to Russia and started issuing coupons to its citizens so only they could buy goods in Ukraine. The rest of the republics also started acting independently around this time and contributed as little tax revenue and resources to the center as possible. Again, the logic behind their policies is understandable, but the effect was to worsen the economic disaster. Protectionism created a breakdown in trade, which only made shortages worse everywhere. When the union government did not receive the expected revenue contributions from the republics, its budget deficits grew much faster than they already had been. The deficits were covered by simply printing more money, which became an immediate cause of hyperinflation.[18]

In the early 1990s, the collapse became imminent. In 1990 and 1991, shortfalls in the budget got much worse than they had even been in the late 1980s. Government revenue covered only 36 percent of planned expenditure in the first quarter of 1991, leaving a gap of 27 billion rubles that had to be financed by an increase in the money supply. Falling production and increased spending on social welfare were responsible for much of the discrepancy. Gross national product fell by 2 percent in 1990 and 13 percent in 1991. Foreign trade revenue also declined, with 1991 exports falling by 33 percent and imports by 45 percent. Yet the biggest problem came from the loss of control over the member republics, as they transferred only about half of their agreed contributions to the central budget. It was unclear how high the deficits actually got, but some estimated the deficits of 1990 and 1991 to be around 200 billion rubles. The enormous deficits were monetized and total bank deposits were over 1.3 trillion rubles in 1991, despite only 157.6 billion in circulation.[19]

The bloated money supply and the huge gap between supply and demand finally led to open inflation and widespread shortages. Official inflation was measured at 5.3 percent in 1990, but the freely set prices on the farmers' markets showed inflation of 29 percent. Despite barely raising official prices, the Soviet state apparently realized that its currency was rapidly losing value, because ruble-to-dollar exchange rates increased at similar rates on the black market and at state auctions. The ruble steadily depreciated throughout 1990, and by the end of the year, black market prices were three to four times higher, on average, than official rates. On the first day of 1991, some prices were finally raised or even liberalized, but many remained fixed or regulated. Open inflation reached about 20 percent in 1990 and 200 percent by 1991. Yet, despite the price rises, shortages actually got worse in 1991 than they were in 1990. This occurred because the increases were not sufficient to balance supply and demand, but they did unleash the repressed inflation that been building for decades. In addition, the level of supply dropped as enterprises reduced output and fewer imports came in.[20]

Table 12. Inflation in the Soviet Union or Russian Federation, 1985-1995

Year	*Official Figure (percent)*	*Highest Estimate (percent)*
1985	1.0	4.6
1986	2.0	-
1987	1.3	-
1988	0.6	6
1989	2.0	8
1990	5.3	20
1991	96.3	200
1992	-	2318
1993	-	841
1994	-	205
1995	-	131

Sources: Shleifer and Vishny, 344; Filatochev and Bradshaw, 739;
Fischer and Frenkel, 39; Hedlund and Sundström, 893.

As repressed inflation became open and shortages worsened, the Soviet economy almost ceased to function. Real income decreased due to the falling value of the ruble, but buying necessities depended more on finding them rather than affording them. According to one estimate, "30 million man-years [were] spent in queues annually—about 25 percent of the waking time of every adult."[21] Consumers had more incentive to look for goods than to work more, so aggregate labor supply decreased. Money lost its function as a store of value, so consumers began hoarding durables and dollars, while firms hoarded their inputs instead of producing. The latter phenomenon was particularly damaging to the economy, because it led to a drop in output and further shortages. Because many prices remained fixed, many producers chose to not honor their contracts with state enterprises and instead sold their output to higher-paying customers. In the absence of a properly functioning currency, bartering and theft also developed. Shleifer and Vishny concluded that "the collapse of the Soviet economy is at least in part explained buy the breakdown of traditional coordination channels and the resulting diversion of labor and inputs."[22]

As the Soviet Union disintegrated, inflation became a regional issue, and the former republics had to deal with their own economic problems. They had to establish their own functioning governments to replace the central control from Moscow. The Central Bank of the USSR dissolved, and the individual republics became responsible for issuing rubles. Anders Åslund argues that one of the main causes of the hyperinflation was maintaining the ruble zone for a year and a half too long. By late 1990, the Soviet Union had ceased to function because the member republics stopped contributing to the central budget. Instead, the former republics were each left with their own deficits, which they all financed with by issuing rubles from their own central banks. This led to even faster inflation due to different banks issuing the same currency without any coordination. In 1992, several of the successor states began issuing their own paper moneys, usually known as coupons, to get away from the depreciating ruble.[23] However, these coupons suffered from their own hyperinflations soon after being issued and were eventually replaced by other national currencies.*

On January 2nd, 1992, Russia finally liberalized most prices, with only a few controls remaining. Resulting price increases were very large that month, 382 percent for producers and 296 for consumers, largely due to all the existing monetary overhang and inflationary expectations. In other words, people expected prices to go up as soon as they were freed and rushed to spend the money that had been printed and languished in bank accounts unspent. This caused velocity to go up, and inflation continued at a rapid pace, reaching a staggering 2,318 percent by the end of the year. The macroeconomic effect of inflation was a shortening of the time horizon for economic decision making. With money losing its value so quickly, people were reluctant to make long-term contracts, and investment in the Russian economy fell by more than 60 percent from 1992 to 1994.[24]

Discussion

The situation got so bad because Soviet authorities refused to recognize and properly deal with the problem of repressed inflation earlier. Decades before the collapse, both Western and Soviet economists realized that the Soviet economy was not immune to inflation. In 1985, Igor Birman and Roger A. Clarke wrote that the problem of the money supply was getting worse in the Soviet Union and needed to be dealt with eventually. They suggested four ideas that could have potentially fixed the issue: "(1) A drastic cut in military expenditure" would have freed up

* According to one family anecdote, people in Ukraine were trading a kilogram of coupons for a kilogram of bread in the early 1990s. Issues of *Ekonomika i Zhizn'* from 1992 have stories of people using suitcases to carry cash and political cartoons depicting absurdly large bags used as wallets, so there may be some truth to such stories. (*Ekonomika i Zhizn,* No. 7, p. 3; No. 10, p. 9; No. 21, p. 2).

resources to produce consumer goods but was unlikely. "(2) A radical economic reform in industry and/or agriculture" could have increased economic performance, but was not a solution as long as the population had no reason to earn more money. "(3) A sharp increase in retail prices" certainly could have restored equilibrium between supply and demand, but would have caused "severe discontent" unless done very carefully "with compensating wage increases." Finally, "(4) some kind of monetary reform designed to destroy most of the accumulated savings" could have eliminated the overhang without causing inflation, but would have been difficult to explain politically.[25]

During the reform debates of the late 1980s, Gorbachev was willing to listen to any viewpoints, "as long as they were socialist."[26] He considered a limited private sector to be desirable, but was very reluctant to accept any form of radical marketization. Many reformers accepted the idea of decontrolling prices, but the greater question of creating market institutions that allow supply and demand to function remained unanswered. To judge Gorbachev by Birman and Clarke's four ideas, he attempted the first three inadequately and did not try the fourth. Military spending was cut by 1.5 percent of the GDP, but this did not alleviate shortages on the consumer market. Enterprises were partially liberalized, but as described earlier, this added more to the money supply than to production. Prices and wages were finally raised in the early 1990s, but again, the increases released inflation without being sufficient to balance supply and demand. Valentin Pavlov, the last Soviet prime minister attempted a monetary confiscation in early 1991, but it was vastly inadequate. Gorbachev cannot be blamed for creating disequilibrium and repressed inflation in the Soviet economy, but his reforms made the problems that he inherited worse instead of better.[27]

Economists differ about whether the Soviet Union should have reformed gradually or quickly in the early 1990s. In 1990, Gur Ofer argued against a quick, "big bang" approach. Because liberalizing prices and marketizing the economy would certainly lead to open inflation, he suggested that prices should be revised and the budget deficit reduced first. The Soviet Union also lacked the proper institutions and infrastructure for a functioning market economy. Thus, rapid marketization would lead not only to high inflation, but enterprises would also fail to operate under market conditions. Ofer's theory was that stabilization should come before market reforms. The primary step necessary to balance the budget would have been to eliminate price subsidies and devalue the ruble, along with confiscating existing real balances and reducing real incomes. However, Ofer realized that a price revision would have certainly been difficult. The idea would have been "widely resisted on political and social grounds" and would have "impose[d] an immediate and sizeable burden on most of the population." [28]

Given the circumstances in late 1991, Anders Åslund argues that a rapid transformation was the best option. According to Åslund, it is politically easier to pass a large package of reforms all at once, while it is clear that there is a crisis that needs to be fixed. He also suggests that a "comprehensive and consistent" reform package is more effective. In Russia, it was necessary to break inflationary expectations and force the rent-seeking managerial elite to respond to market forces, namely consumer demand. This could only occur if "a strict budgetary and monetary policy" were quickly implemented. In sum, the more rapid and radical the market reforms, the sooner the distortions and corruption of the old system would be eliminated.[29] He also rejects the notion that the Soviet Union dissolved too quickly, arguing that maintaining the ruble zone a year and a half too long led to hyperinflation.[30]

After the Soviet Union finally fell, triple-digit inflation was running rampant and the population was near starvation, so authorities had to act quickly.[31] Economists do agree that the government should have reduced its deficit and the monetary overhang before liberalizing prices.[32] However, Fischer and Frenkel assert that this choice was not available in 1992. The Russian budget deficit stood at 20 percent of GNP, and it had no "external resources [available] to help finance the budget and stabilize the currency." In that circumstance, "the choice was between (a) liberalizing prices and risking hyperinflation and (b) maintaining price controls with the consequence of growing shortages." A growing number of transactions were occurring on the black market anyway, so the choice was essentially between hidden and open inflation. With no time for gradual reform due to the rapidly collapsing system, policymakers chose to go with "shock treatment" or the "Big Bang" approach. The transition to a market economy was expected to be painful, so the point of shock therapy was the get the pain over quickly.[33]

Hedlund and Sundström instead suggest that currency reform was possible and should have been enacted. A majority of the overhang was due to money that was printed in 1991. According to these two authors, the printing presses created more money in that year alone than in the previous 30 years, 137.8 billion in 1991 compared to 133.8 billion from 1961-1990. They blame Yeltsin for promising substantial benefits to the population, in the midst of his power struggle with Gorbachev, with no way to pay his promises other than money creation. Yeltsin's camp moved to control the Russian central bank, which financed the Russian Federation's 1991 budget deficit that was equivalent to a ridiculous 31.9 percent of its GDP. The overhang created by this expansion in the money supply could have been eliminated by currency reform. Hedlund and Sundström agree with Ofer that currency reform would have been politically difficult, but suggest that it was possible in the context of shock therapy, rather than gradual reform. Not only would it have made economic sense, but could have also been done in politically palatable way "by introducing graduated rights for the changing of old rubles into new currency." They find it strange that Russia did so little counteract inflation.[34] This counters Fischer and Frenkel's idea that the authorities had no choice but to let hyperinflation happen.[35]

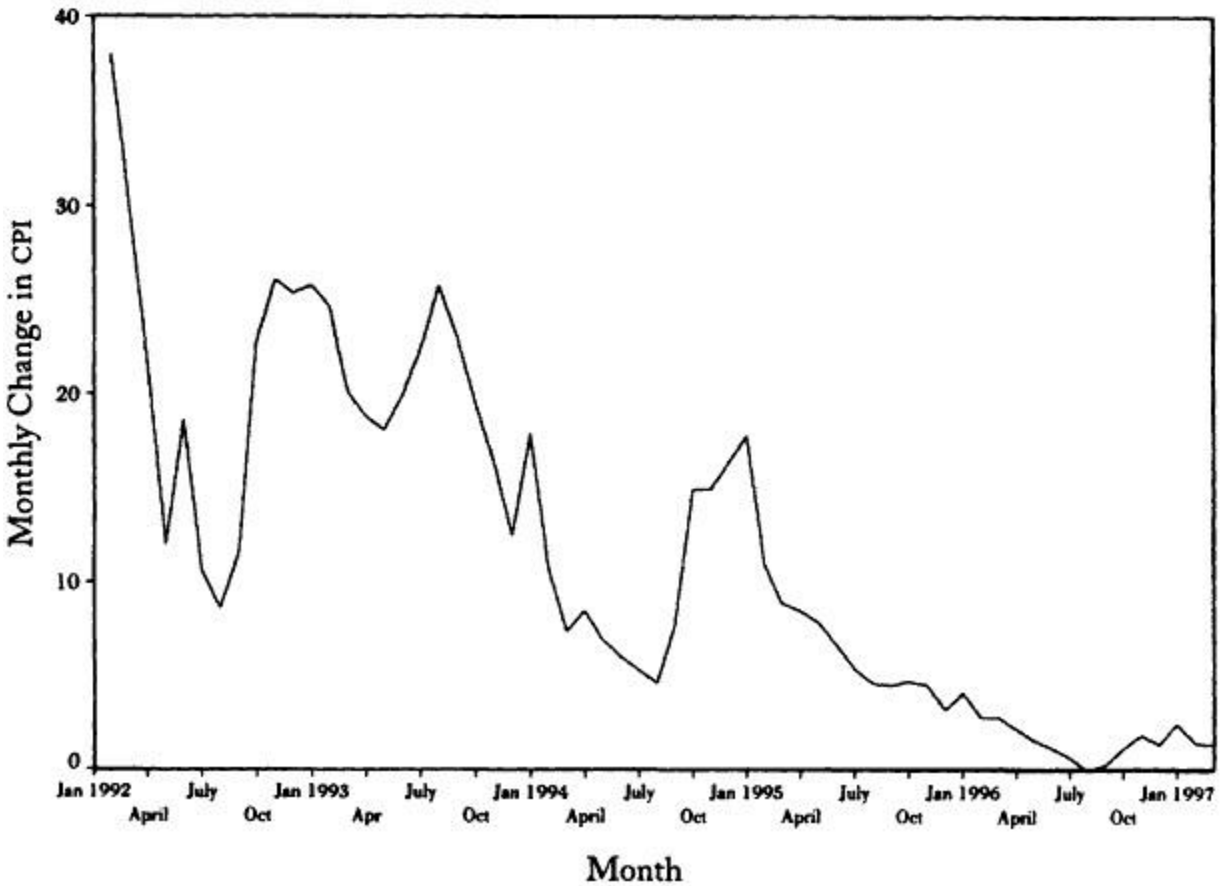
Stabilization

High inflation continued in Russia until 1995, as several attempts to stabilize the ruble failed. The first attempt was in early 1992, when Egor Gaidar instituted his shock therapy reforms, rapidly privatizing the economy and cutting the budget deficit. Thus, monetization of deficits became less of a factor in causing inflation. However, the Central Bank of Russia (CBR) continued far more to the money supply by granting credits to commercial banks. These credits totaled 457 billion rubles in just the first half of 1992, which was almost equivalent to the monetary base at the beginning of the year. Viktor Gerashchenko, the former head of the Soviet State Bank, became head of the CBR in July 1992 and continued granting credits to agriculture, industry, and the budgets of Russia and the former Soviet republics. After a decline from the peak in January, inflation began rising against after July. In mid-1993, finance minister Boris Fyodorov negotiated an agreement with the CBR to limit how much credit it granted, but the central bank broke the agreement and continued granting excessive credit due to lobbying pressure. This lead to another increase in the inflation rate in January 1994. This situation repeated itself again in a third stabilization attempt in 1994, in which credit was temporarily tightened, then expanded again.[36]

The ruble was finally stabilized in 1995 when the Russian government and the CBR found a way to bring profits to commercial banks without creating inflation. Throughout the first half of the 1990s, commercial banks and enterprises profited from inflation and lobbied the government and the central bank to keep credit rolling. As Austrian economist Murray Rothbard has argued, those who receive newly printed money first see the most benefit because they use it before it inflates. People who receive the money last have the most to lose, because it has lost its value by the time it gets to them. Thus, Russian commercial banks were able to receive credit at low or negative real interest rates. In return, the banks funded the election campaigns of Russian politicians, or conversely, threatened to slow down the economy if their credits stopped. In May 1993, the Finance Ministry started offering short term government securities (GKOs) with rates that were significantly higher than inflation, and the profits off GKOs were tax free. After late 1994, banks started investing more heavily in GKOs and were able to make profits that compensated for what they lost from the curtailment of central bank credit. Since the banks were now lending to the state at fixed interest rates, inflation was no longer in their self-interest. Finally, the government also made a deal with crucial enterprises, especially in the energy sector, which had also been recipients of credit. The fuel and electricity sectors agreed to continue supplying their products without requiring additional payment from the budget in exchange for toleration of their past and present tax arrears.[37]

With the pro-inflation lobby happy and paid-off, the Russian government and central bank were able to make several changes to ensure that inflation remained low. Reserve requirements for commercial banks were more than double from January to August of 1995. Real interest rates went up to 35 percent in 1995, and as explained, central bank credits to private banks and enterprises significantly decreased. The central bank also stopped granting credit to the government for its budget deficits. Instead, the sale of the new securities and foreign borrowing helped to pay for the deficit and reducing the need to new money creation. The government almost managed to reduce the deficit overall, down to manageable 2.9 percent of GDP in 1995. Stabilization did not lead to a noticeable increase in unemployment, which remained around 9 percent. The decline in GDP, which had been in double digits from 1992 to 1994, improved to negative 4 percent in 1995 and 1996, before eking into positive territory in 1997.[38]

Figure 4. Monthly Inflation Rate, Russia (1992–97)



Source: Daniel S. Treisman, "Fighting Inflation in a Transitional Regime: Russia's Anomalous Stabilization," *World Politics*, Vol. 50, No. 2 (Jan., 1998): 243.

Social Effects

Inflation led to a precipitous drop in living standards in the early 1990s. Nominal incomes went up as they chased after rising prices but only compensated for about 80 percent of the increased costs. In other words, inflation caused real incomes to decrease by around 20 percent. The existence of poverty was never acknowledged in the Soviet Union before

Gorbachev's time and remained difficult to estimate. By the most reasonable consensus, it appears that about one-third of the Soviet population, or almost 100 million people, was below the poverty line in 1991. The drop in standard of living was worse in some regions than others. The largest cities, Moscow, St. Petersburg, and Kiev, had the highest inflation rates and resulting decreases in real incomes: 31 percent in Moscow, 24 percent in Kiev, and 20 percent in St. Petersburg. The Central Asian republics were also hit harder by inflation than the Slavic ones. Large families, which were mostly in Central Asia, found it very difficult to feed all of their children in the wake of rising prices and very meager state assistance. In the three main Slavic republics, eleven percent or less lived below the poverty line, compared to a staggering half or more of the people in Central Asia.[39]

Inflation also disproportionally hurt some groups, such as women and the elderly, and wiped out everyone's life savings, while the rich were only ones to benefit. Even before the collapse, most women earned far lower salaries than men, and the further reduction in real incomes made life even harder for time. Retirees relied on fixed monthly pensions that lagged even further behind inflation than workers' incomes, and worse still, the checks were not delivered at all for months at a time during the crisis. Hyperinflation also destroyed life savings on which workers and retirees hoped they could depend. For example, one college-educated woman had earned a monthly salary of 120 rubles and saved 10 rubles a month for many years to amass 3000 rubles in savings by the early 1990s. Hyperinflation made this considerable sum worth the equivalent of 3 rubles.[†40] Those who benefited from inflation were the "'new Russians', i.e. people who operate at or beyond the outer limits of law and common decency."[41] Average real wages for most groups fell four years in a row, from 1992 to 1995. However, the

[†] This was made official in 1998, when the ruble was revalued at a ratio of 1000 to 1.

richest 20 percent were the only group to increase their incomes, showing growing inequality. Average Russians now resent the newly rich oligarchs as thieves who gained their wealth by stealing from state enterprises.[42]

Perestroika and inflation also led to "the first sustained food crisis since World War II."[43] This was nothing approaching another famine, but food became more expensive and difficult to find, and the quality of diets dropped. Large cities and the Central Asian republics were also hit harder by food shortages. The cities relied on deliveries from the provinces, which stopped showing up due to the separatism and hoarding described earlier. In 1989, Moscow already reported that many stores had no meat at all, and most other foods were also in shortage. Per capita consumption of potatoes, fruits, and vegetables was lower in Moscow in 1985 than it was 1980, and dropped even lower in 1989. Citizens of Leningrad were particularly troubled by the new food shortages, as they remembered the million deaths from starvation during the Second World War. Due to rising inflation, the percentage of household incomes spent on food increased by 6 percent in 1991 over 1990, yet the quantity and quality of the food available both declined. The overall daily caloric ration dropped by 10 percent, largely because consumption of meat, milk, butter, and eggs fell even farther. People were forced to compensate by eating more carbohydrates, such as bread, potatoes, and sugar. Worse still, the citizens of Turkmenistan, Tajikistan, and Uzbekistan ate less of not just animal products but even the starchy foods. The food crisis had damaging effects on the health of Soviet citizens and may have been responsible for the falling birth rate and rising death rate in 1991.[44]

As shown in the following chart, food production in Russia continued to drop precipitously after 1991. Although overall caloric intake stabilized after 1992, due to increased imports and production from private gardens, Russians have a number of complaints about the post-Soviet food supply. At the height of the inflationary crisis, huge crowds gathered to purchase any type of meat being offered, and people had to grab whatever they could before being shoved out of the way. Throughout the 1990s, Russians continued to get less of their daily

Table 13. Food Production in Russia per Year Compared to Previous Years, 1991-1995

Food category (in tons, unless otherwise noted)	*1991*	*1991 as a % of 1990*	*1992*	*1992 as a % of 1991*	*1994 as a % of 1993*	*1995*	*1995 as a % of 1994*	*1995 as a % of 1991*
Total food production	-	91	-	85	-	-	-	
Meat (mil.)	5.6	84	4.4	76	75	2.5	76	44.6
Sausage products (mil.)	2.1	91	1.5	73	102	1.27	82	60.5
Milk products (mil.)	18.5	89	9.5	51	83	5.4	76	29.2
Animal fats (thou.)	724	87	746	103	67	419	86	57.9
Cheese (thou.)	394	86	295	75	89	217	76	55.1
Fish and fish products (mil.)	3.8	89	3.1	83	78	1.6	108	42.1
Margarine (thou.)	627	78	560	89	-	-	-	
Vegetable oil (thou.)	1149	99.2	954	82	76	773	85	67.3
Sugar (mil.)	3.1	87	3.9	114	69	3.1	115	100
Bread and bakery products (mil.)	19	104	16.9	89	82	10.9	88	57.4
Confectionary products (mil.)	2.6	92	1.8	69	-	-	-	
Flour (mil.)	20.7	99.8	19.9	97	87	14	88	67.6
Groats (mil.)	2.7	93	1.9	71	71	1.4	90	51.2
Macaroni products (thou.)	113	107	1.1	99	-	-	-	
Preserves (mil. cans)	7.0	85	5.3	77	-	-	-	
Alcohol (mil. decaliters)	82.2	104	76.3	92	78	122	98	117

Note: The economic facts published for 1993 did not include detailed food production statistics but did note that purchases of meat products, sugar, and vegetable oil grew from 12 to 26 percent, and purchases of milk products by 6 percent, as the population adapted to "unorganized" food trade. Production statistics for 1994 also unavailable.

Source: *Ekonomika i Zhizn'* (1992, no. 4; 1993, no. 4; 1994, no. 8; 1996, no. 6).

caloric intake from meat and milk products and more from starchy foods such as bread and potatoes. According to conventional dietary advice, this has actually been good for their health, since animal fats are blamed for cardiovascular diseases. However, iron deficiencies, diabetes, and obesity are also cited as some of the main nutrition-linked health problems in Russia. Iron is most readily available in red meat and other animal sources, a lack of which in the diet can lead to an iron deficiency. A growing number of nutrition experts also caution against excessive carbohydrate intake and blame high incidences of obesity and diabetes on the consumption of too many sugary and starchy foods. Perhaps the most serious dietary imbalance in the 1990s was that only 3 or 4 percent of Russian caloric intake came from fruits and vegetables, which all health experts would agree is far too low. Now, there is a wide variety of meats and produce offered in stores, but Russians complain that most of it comes from far away and has numerous additives that were not used in Soviet times.[45]

Political Effects

As the problems of the Soviet Union became readily apparent to its population, they became angry but were not sure whom or what to blame. Initially, it seemed like the problem was communism, which never lived up to its promise and could not match the prosperity of the capitalist West. By its last few years, very few people in the Soviet Union cared about Marxism-Leninism.[46] However, when Gorbachev started chipping away at central planning, the economy suddenly became much worse than it had been for the previous several decades. If nothing else, the post-war Soviet economy was stable, and it managed to consistently provide a minimum of comfort. Perestroika took away even this guaranteed minimum. When prices remained steady, there were always shortages, but when the prices started to rise, shortages got worse *and* everything became harder to afford. Many blamed Gorbachev and the central government for the general failure of the economy, but shop managers who raised prices were also treated with hostility. According to William Moskoff, inflation hurt the Soviet people's confidence in economic freedom.[47] After all, Gorbachev had allowed them some freedoms, and the result was economic collapse and widespread misery for most people. This made the Soviet population ambivalent about whether communism or capitalism was the right answer. Communism gave them shortages, but when it ended, conditions somehow became even worse.

Poll results from the early 1990s show that support for democratic capitalism in the Eastern Bloc varied depending on whom respondents blamed for the economic chaos. Raymond Duch conducted a survey of the European USSR in 1990 and found that economic hardship did not inspire the Soviet people to instantly reject democracy and capitalism, because they still blamed the failing economy on communist rule. Far more Soviets supported democratic and free market principles than authoritarian and communist ones. The author also studied poll data from Poland, Hungary, and Czechoslovakia, which showed slightly different results. As time passed and democratic capitalism became more established, people began to associate it with the continuing economic problems, although they were still not ready to abandon it.[48]

Powers and Cox did a similar study based on Polish polling data from 1993. They discovered that economic hardship did not necessarily drive Polish voters back towards communism. Of greater importance was whether they considered the communist system or the first-wave of free market reformers responsible for the economy's problems the decline in living standards. On a scale of 1 to 5, respondents assigned slightly higher blame to the communist system than the first-wave reformers, a mean of 3.1 for the former and 3.6 for the latter. As shown in the chart below, the largest percentage believed that the reformers were mostly to blame and not the communist system. However, the second largest number responded that both deserved blame, and third largest considered communism mostly responsible. Nevertheless, the most leftist party, Alliance of the Democratic Left, performed the best in the 1993 Polish election, and two of the next three runners-up also leaned towards the left.[49]

Table 14. Relationship between Blame of the Communist System and Blame of First-Wave Reformers in Poland

	First-Wave Blame		
	Low	*Medium*	*High*
Communist system blame			
Low	6.0%	1.5%	34.3%
Medium	1.0%	6.9%	3.0%
High	18.5%	2.1%	26.8%

Note: High blame = responses of 4 or 5; low blame of 1 or 2.

Source: Powers and Cox, 619.

According to a 1991 survey by the Pew Research Center, a majority of respondents in each of nine former Soviet bloc countries polled approved of the transition to democracy and capitalism. However, the degree to which people accepted communism's demise varied greatly by country. The Eastern bloc republics, which were nominally independent but actually controlled by Russia, had the largest majorities in favor of moving towards free markets and democracy. These countries only became part of the Soviet sphere of influence after the Second World War and had communism forced upon them at that time. As a result, they were not as accustomed or attached to the Soviet system and in fact tended to resent Russia's dominance over them. This is evidenced by the intermittent worker rebellions in these countries and their rapid exits from the Bloc as soon as they realized Gorbachev would not use force to stop them.[‡] Ukrainians had also seen the worst of Soviet tyranny under Stalin and welcomed democracy as

[‡] "The 40,000 aristocrats and fascists of the Csepel Works strike on." – A sarcastic poster from the Hungarian workers' revolt of 1956 that illustrates the irony of official communist propaganda labeling dissatisfied members of the proletariat right-wing or bourgeois.

much or more than some of the Eastern Bloc nations. As the leading ethnic group of the Soviet Union, Russians were the least unsatisfied with the existing political order, although a majority of 61 percent still favored democracy. However, Russia and Ukraine, the most populous former Soviet republics, were both almost evenly split on whether they wanted capitalism. Thus, it seems that Soviet citizens were frustrated with communism but unsure if capitalism was the right answer.[50]

Table 15. Approval of Change to Democracy (in percent)

Country	*1991*	*2009*	*Change*
East Germany	91	85	-6
Czech Republic	80	80	0
Slovakia	70	71	+1
Poland	66	70	+4
Hungary	74	56	-18
Lithuania	75	55	-20
Russia	61	53	-8
Bulgaria	76	52	-24
Ukraine	72	30	-42

Table 16. Approval of Change to Capitalism (in percent)

Country	*1991*	*2009*	*Change*
East Germany	86	82	-4
Czech Republic	87	79	-8
Poland	80	71	-9
Slovakia	69	66	-3
Bulgaria	73	53	-20
Lithuania	76	50	-26
Russia	54	50	-4
Hungary	80	46	-34
Ukraine	52	36	-16

Source: Pew Research Center.

Pew also conducted another survey asking the same questions in 2009, the results of which are likely to be the ones more surprising to Western readers. East Germany, the Czech Republic, Slovakia, and Poland have held firm in their support for both capitalism and democracy. However, Hungary, Lithuania, Bulgaria, and Ukraine have all seen significant drops in public support for the twin systems of liberal society in the last twenty years. Opinions in the first three of these countries are split fairly evenly on whether the transition was desirable, while a large majority of Ukrainians now disapprove of the change on both accounts. As for Russia, its levels of support for liberal social systems were among the very bottom originally, but they have not fallen nearly as far as in the other countries in this second group.[51]

These declines in support for liberalism come despite the fact that respondents in every country reported higher life satisfaction in 2009 than in 1991, often significantly so. As one might expect, the countries with the lowest life satisfaction have large majorities that feel that people are worse off now than they were under communism. However, the other seven countries polled also have significant pluralities that feel the same way. Another interesting caveat to this data is that responses vary greatly by age group. In every country but Ukraine, a majority of respondents ages 18-29 continue to favor democracy and capitalism, but this support consistently decreases as age increases. Life satisfaction similarly decreases with age.[52]

Table 17. Percent Satisfied with Life

Country	*1991*	*2009*	*Change*
Poland	12	44	+32
Slovakia	13	43	+30
Russia	7	35	+28
Czech Republic	23	49	+26
Lithuania	13	35	+22
Ukraine	8	26	+18
Bulgaria	7	15	+11
Hungary	8	15	+7
Germany	44	47	+3
East	15	43	+28
West	53	48	-4

Table 18. People Worse Off Than Under Communism? (in percent)

Country	Worse	About the same	Better
Hungary	72	16	8
Ukraine	62	13	12
Bulgaria	48	15	23
Lithuania	48	15	23
Slovakia	48	18	29
Russia	45	15	33
Czech Rep.	39	12	45
Poland	35	12	47

Source: Pew Research Center.

According to interviews conducted by the author, the chaos and poverty of perestroika and inflation discredited democracy and capitalism in the eyes of many Russians. Although the standard of living under communism was far lower under communism than in the West, conditions were stable and virtually unchanging, so people grew accustomed to them. Even in the 1980s, people in Russia lacked items which are considered essential in the West, such as telephones and toilet paper, yet none of the people interviewed reported feeling especially deprived. Although the selection of food and goods was bland or inadequate, the necessary minimum was always available. During the Gorbachev years, they heard that living standards were much better in the West and hoped that freeing the economy would bring the same to them. However, these hopes were soon met with disappointment. In contrast to the communist days, perestroika and hyperinflation stood out in the interviewees' memories as catastrophic disturbances that made their lives worse than they had always been before. In general, most Russians today do not want to go back to communism, but they do favor a state-guided economy.[53]

Despite some electoral irregularities, the presidencies of Vladimir Putin and his counterpart Dmitry Medvedev generally reflect the political preferences of Russia's citizens. After the shock therapy reforms and relatively free democratic competition of the 1990s, Putin has been gradually steering Russia away from both capitalism and democracy. In an interview from 2006, Putin spoke about the need to additional state intervention in the economy, such as state investment, subsidies, price regulations, protectionist tariffs, etc. While some of this rhetoric echoed the Soviet days, Putin and Medvedev's recent policies are more akin to state capitalism. With allegations of voter fraud and poisoning of opposition leaders frequently in the news, Putin's lack of commitment to democracy is perhaps to well-known in the West to require much elaboration. In short, Russia's legislature is very weak, the president is very powerful, and corruption is widespread. An international rating agency, Freedom House, has downgraded Russia's score on civil and political rights continuously since 1997.[54]

Opposition to Putin is relatively weak and not entirely committed to democracy and capitalism either. Since the Soviet Union fell, the largest opposition party in Russia has been the reformed Communist Party, but it has never been able to regain power through the ballot box. Numerous other opposition parties have formed over the past twenty years, but none have had any considerable electoral success. Most of these parties have been based around particular leaders, which has made it easier for those in power to deal with political threats as individuals, rather than institutions. Some of these parties have merged with Putin's party, United Russia, while others have faded from significance. The only other party which has consistently remained a somewhat of a force in post-Soviet Russia is the misnamed Liberal Democratic Party of Vladimir Zhirinovsky. More accurately, Zhirinovsky's views can be described as far-right, nationalist, racist, or imperialist. If there were any danger of the Russian hyperinflation leading to a similar result as in the Weimar Republic, it would be with Zhirinovsky. However, his party hit a peak with 22.8 percent in the 1993 Duma elections and has been unable to improve its results since.[55]

Table 19. Russian Presidential Elections, 2000-2012

	2000	2004	2008	2012
United Russia (Putin/Medvedev)	53.4	71.3	71.2	63.6
Communist Party (Zyuganov/Kharitonov)	29.5	13.7	18	17.2
Liberal Democratic (Zhirinovsky/Malyshkin)	2.7	2.0	9.5	6.2
Others	14.4	13	1.3	11.79

Source: Åslund, 208, 245.

Most Russians have shown no interest in experimenting with any new ideologies and seen content to elect establishment-picked successors. Although Boris Yeltsin had become very unpopular by the late 1990s, his chosen heir, Putin, has been in power ever since. When Putin switched offices with Medvedev to appease constitutional technicality, Russian voters went along with the façade. After months of intrigue of whether Medvedev or Putin would run in 2012, Putin rather unsurprisingly became President again. His winning percentage fell to 63.6 percent, down from a peak of 71.3 percent in 2004, but still much higher than his total of 53.4 percent from the year 2000. More importantly, Putin's share of the vote in 2012 was over three times higher than his closest opponent from the Communist Party, and the other candidates were mired in the single digits. Thus, even if there is some degree of voter fraud in Russia, it appears that a genuine majority of Russians is willing to follow Putin down the road to moderate authoritarianism.[56]

Conclusion

Partly due to the trauma of perestroika and hyperinflation, many people in former communist countries have come to view the transition to democracy and capitalism unfavorably. However, when the transition was in progress, larger majorities saw it as necessary. Consumers had grown tired of constant shortages of most goods and hoped that capitalism and democracy would improve their lives. Instead, the economy got worse under Gorbachev, as his reforms failed to increase productivity or supply of consumer goods, but did increase budget deficits. When the Soviet Union completely collapse and Russia moved ahead with full-fledged democracy and capitalist shock therapy, the first result was hyperinflation. The collapse of the ruble benefitted only a small number of well-connected or corrupt "new Russians," while the rest of the population suffered. Shortages actually became worse initially, life savings and monthly pensions became worthless, and the quality of diets drastically declined. These traumatic experiences have tempered the enthusiasm of many for capitalism and democracy, especially the elderly, who suffered more than most. In many former communist countries, citizens have been willing to accept a return to authoritarianism in both politics and economics for the sake of stability and some insurance of material comfort.[57]

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CHAPTER 5
CONCLUSION

Since the inception of the Soviet Union until its collapse and beyond, inflation and price controls have influenced Russian living standards and politics. Inflation and food shortages helped bring down the Russian imperial and provisional governments, which paved the way for the Bolsheviks. However, the first few years of Bolshevik rule led to hyperinflation, outright famine, and growing rebellions. In order to consolidate their political power, the Bolsheviks realized that they needed to control inflation. They successfully stabilized the ruble in the 1920s with conventional fiscal conservatism, but inflation began to rise again after Stalin took over and the economy was collectivized. Stalin instituted a widespread system of price controls that lasted until the end of the Soviet period. After grappling with inflation before and during the Second World War, the Soviet government managed to stop growing prices with a currency reform in 1947.

In the post-war era, Soviet planners effectively managed to keep prices under control. However, inflationary pressure could not be completely eliminated by simply fixing prices. After the 1960s, workers' wages continued to grow faster than the prices of goods. In a market economy, prices act as a signal to tell producers what to produce and how much. In the Soviet economy, planners decided what to produce and how much it should cost. Since they never adequately increased either the prices or the supply of food and consumer goods, the result was constant shortages. Shortages lasted as long as the Soviet Union did and created very low living standards in comparison to the West. Incomes continued to fall further behind, while many food products and goods that were ubiquitous in the West were almost unavailable in the Soviet Union.

Mikhail Gorbachev, the last Soviet leader, hoped to solve the problems that had been plaguing the Soviet economy for decades, but instead, his efforts made the existing problems worse and created new ones. Gorbachev's reforms, known as perestroika, allowed just enough freedom to initiate the collapse of the Soviet command system, but not enough to create a functioning market economy. The constituent parts of the Soviet Union ceased to function together as a unit and started taking short-sighted actions to try to help themselves which actually hurt the entire economy. In addition, the government started running large budget deficits under Gorbachev and paying for them by simply printing money. In short, Gorbachev's policies led to the collapse of the Soviet Union, even greater shortages, and Russia's second hyperinflation. However, the hyperinflation started when prices were freed, just after the Soviet Union ended, so many people associated the chaos of the 1990s with free markets and democracy. As a result, most Russians today are skeptical of full-fledged capitalism and believe that a state-guided economy is necessary to ensure stability.

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