

THE ECONOMIC THEORY

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Historical examples of various methods for recovery from crisis*

The crisis creates measures to combat it

The following text (with some abridgements) is the first chapter of the book by Makarov V.L. Social clusterizm. Russia's challenge / M.: Business Atlas, 2010. — 272 p. In the introduction to the book, the author points out the following: In this book the reader will find a set of proposals and arguments about society and economy without devastating crises. People do not like crises, they want them to come to an end, and even better that there would be no crises at all. But on the other hand, crises purify, they mobilize to super efforts. It is after crisis when the world updates. Then is it necessary to strive for a society without crises? I'm trying to convince the reader that it is necessary... We give strong arguments in favor of the fact that it is Russia that can show an example of building such a society to the rest of the humanity (p. 10)... The basic idea of the book is looking for and hopefully finding in relation to modern society the right balance between rigidity and flexibility, which ensures stability of the system (p. 11).



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This chapter has an introductory, in some ways a warm-up character. The given examples should convince of the importance of the problem of softness and hardness combination.

1.1. Rationing system

What saved the people from starvation during World War II? It was **rationing system**. It was an island of stability in consumer chaos. The distribution of cards is a stable layer of the economy coexisting with the rest of the economy. The cards themselves play the role of the

second, stable currency, not affected by inflation. And the main idea in the rationing system is the norm. The norm usually depends on the category of the consumer, and this dependence can be fair and not very fair. But that's another problem. Variants of the rationing system exist in a calm peace time perfectly well. These are tickets for the homeless, the so-called special tickets for athletes, for a company, agency or community, the time tickets for participants of any event.

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1.2. Parallel currency

One of the most effective ways to combat hyperinflation is the production of a **parallel currency**, the trust to which is higher among the population. The nature of the parallel currency may be different. For example, in the U.S. in one of the states the governor stamp is put on the usual dollar, turning that dollar in a special currency. In Russia during the NEP there was an attempt to introduce a gold ten-ruble banknote (tchervonets). The simplest and most common way is to use as a more reliable currency of another country as parallel. However, in reality, the latter method does not exceed the stability, but on the contrary, as there arises the dependence on another country.

1.3. Mixed Economy

The transition from one social system to another is as a rule, a crisis, and even a revolution. **Mixed Economy**, by its very name talks about mixing of economic mechanisms of different nature. Mixed economy appeared just by changing the social system. We leave aside the mixed economy born during the transition from a feudal to a capitalist market. But the planned economy that was born in the depths of the market one is the biggest invention of mankind, or more precisely of the post-revolutionary Russia. It is surprising that this new type of economy has remained outside the attention of renowned economists of both that time and the modern ones. Period of War Communism and then the NEP have been studied mainly from a historical point of view. In essence, there was no careful scientific analysis of this new type of economy, a mixed economy, which combined fundamentally different mechanisms: the market and the planned ones. And the planned was the leading one, and the market mechanism was a supporting, a supplementing one. In the prewar years, a peculiar type of economy had been formed, which is sometimes referred to as a “mobilization” one. In the mobilization economy the market mechanism was playing, in fact, the auxiliary role, so that it was almost not noticed. Scientists did not notice it either who would have to analyze this peculiar mixture of the two mechanisms.

Only in the 70-s of XX century, scientists-economists finally paid their attention to the phenomenon of mixing mechanisms. There appeared works in which the planned economy was interacting with the so-called second economy (see, for example: Stahl II D. O., Alexeev M. (1985). The second economy was understood as a legal market share of farms and household chores, and also shadow economy. In the 80-s of XX century there was flowering of studies of mixed economy with a leading planned principle.

1.4. Types of mixed economies and their names

There appeared a lot of terms for defining this mixed economy: two-stage or two-layer economy, double track economy; two floors' economy; double or dual economy. What is this all for? First of all it was done to save the planned economy, but in reality the socialism, socialist system. The proponents of the so-called kosygin's reform understood that the rigid socialist system is not viable. Oskar Lange, Ota Shik and others were developing the theory of market socialism, the essence of which is the introduction of market mechanisms in the planned system. Gorbachev's cooperatives were an attempt of practical realization of this theory. Let me stress again: the purpose of the mixed economy of this type is to save the socialist system in the form in which it was understood by the authors.

1.5. Cooperatives – the creators and destructors

Gorbachev's cooperatives were the creators and destructors.

In the late 80's – early 90's an intense process of establishing cooperatives started. Under Gorbachev there appeared cooperatives in various sectors of the economy, that is legitimate private sector with market prices. Thus a mixed economy was officially recognized. Appearance of a new institution - the private sector – was, no doubt, a revolutionary event. But all the other institutions remained unchanged. For example, the Central Bank, with its technology of money circulation management was functioning as before. As a result, an influx of wages not pro-

vided with goods poured into cooperatives as into a black hole. There appeared a famous “monetary overhang”. Instead of pointing the deficit, which was expected (according to the educational textbooks) the introduction of the private sector, on the contrary, caused a sharp deficit aggravation. In China, there was no such reaction to the introduction of cooperatives for the simple reason that the state continued to hold the level of wages under its own control, although it was not easy to do (see, for example: Justin Lin, Fang Cai and Zhou Li (1996). The Russian government went on the line of least resistance. It allowed not only to the uncontrolled growth of wages in the cooperatives, but also the interpenetration of these cooperatives with the state-owned enterprises, which led to the initial phase of stealing the state’s property. The first rich have made their capital at the difference between state and market prices as one and the same goods had two prices. An institute, which would have prevented enrichment through the difference between state and market prices, had not been established, again, in contrast to China, which officially recognized a system of dual prices and, accordingly, the reporting and statistics on state and market prices were separate.

1.6. Alternative: cooperativization or double-layer economy

So, the first stage of transition from a planned economy to a market one can be carried out, and is being really carried out in two ways. One of them is through a two-layer economy; the other is through massive creation of cooperatives and joint ventures. With two layers at a single (state) enterprise the management and the staff, however, remain united, with almost a single goal: to fulfill the state order (plan) and make more profit. With the cooperative way the enterprise is split: those who remain in state enterprise live according to their laws, those who went to the family of cooperatives, foraging around the enterprise, live under other laws. As a rule those who are the most enterprising, the most qualified, the most dissatisfied and most unprincipled are leaving.

With a two-layer method the enterprise is trying to use its resources and capacities effectively under a single management. With a cooperativization of parts of resources the interests are different up to the opposite. A cooperative based on an enterprise makes it (enterprise) a grave digger. (The irony is that now in the crisis of the real sector, one way to save a bankrupt or non-working enterprise is to run a small business on it. In this case the area, equipment, and most importantly - the labor force is used at the very least. Unemployment and social conflict can be avoided.)

Therefore the class of cooperatives emerged in the late 80’s - early 90’s is a rather contradictory phenomenon. On the one hand, these are energetic, enterprising people who can work 24 hours a day. On the other hand, many of them made business not in a productive activity, which would have added economic power to the country, but in the veiled or uncovered stealing the state’s facilities and resources.

B.N. Yeltsin and his team who came to power in 1991 faced two economies, living de facto under the different laws. State price for crude oil in late 1991 was about 200 rubles per ton, while the market price was ten times higher. Salary was regularly paid, but there remained less and less goods, even essential ones in the state trade. Ruble was drastically depreciating; the State’s foreign exchange reserves were dwindling away. The power once again faced the alternative - either to merge the two economies, allowing them to live under a single law or to leave them on for a while separated, but at the same time ensuring both the conditions of existence and development. The first way that actually went the Russian economy is generally said to be liberal. We’ll talk about it a bit later. The second way is double track economy.

1.7. Double track economy

In a double-track economy the public sector lives by its own laws, the private one – by on its own. Technically, it is attained by introducing a parallel currency serving the state part of the economy. People working in the public sector get salaries in a parallel currency, which is spent

on buying goods at government prices. The most subtle point here is the interaction between the two economies, in particular, the establishment of the exchange rate between the currencies, and general organization of monetary circulation of parallel currencies. It is clear that the second way is technically more difficult than the first one; it requires more elaboration and preparation. However, it leaves people a choice: in what economy to work, and, ultimately, what way of life to lead. This way equally takes into account the interests of all population groups, not just its most active part as the first one. In this sense, the second way is more democratic, and less imposed on the population.

It should be emphasized: the very idea of double-track economy involves competition, which is known to be an engine of progress. The two ways, the two sectors compete with each other. They are fighting for people, for the quality of life, for the efficiency of the economic mechanism. In this competition in the evolutionary process must be born a new economy, which will unite the advantages and overcome the drawbacks of both sectors. The search is continuing.

1.8. A liberal or a shock way

Yeltsin and his team decided to follow the first, the simplest and most natural way, the way of least resistance: to merge the two economies into one. This way seemed to be attractive, supported by the West, strongly encouraged by the young liberal economists. This way was followed by the former socialist European countries. At the same time it was a bet on the most energetic part of society, hungry for change, eager to life success and enrichment. And most importantly, perhaps, is that in the minds of the leaders and ideologists secretly a successful American model of economy and society was looming.

With the help of cooperatives and other ways people learned how cheat money income, which led to the well-known “monetary overhang”, i.e. to the huge sum of money not secured by commodities. It is natural that, in full accordance with the market economy laws it became unprofitable to trade the products openly in the usual

way, because the prices were regulated by the state. Queues, cards, tickets, shadow and half-shadow market were becoming larger in scale. A typical trait of that time: not knowing what was happening, the government did not find anything better than to agree to a humanitarian assistance of the international community that was extremely humiliating for a great power, and what is more important it helped absolutely nothing, quite the contrary. It was the distribution system that was weak generally. There were enough of consumer goods produced at that time, in any case more than now, when there is everything in the stores.

It is now possible to pre-evaluate where this way (the course) led and is leading further. In principle, the liberal way has proven its effectiveness for a stable economy with a formed set of market institutions and the relevant mentality of the population. The most striking example is the United States. The set of market institutions mentioned above includes: a well-established, habitual to the public tax system, banks, including mortgage, investment, etc., insurance companies, financial markets, a developed network of legal, consulting, audit companies, and many other things that we are still having in the initial, and even embryonic state. But the most important thing in a set of market institutions is a legal system with the system of coercion to follow the laws. All this allows the State to provide its citizens a considerable economic freedom to engage in business. Thus, institutions and economic freedom (the second is the main slogan of the liberal economists) are the two sides of one coin. One side is pointless, or completely ineffective without the other. What happens when one - economic freedom - is available, and another - market institutions - is not, you can see with your own eyes in our own country.

Liberalization of prices, foreign trade, business registration, purchase (or distribution) of public property and other liberalization gave the freedom in essence, without frames, without any restrictions. As a result, in full accordance with economic laws the most effective (and let me add, the easiest) business consisted

in the conversion of state property in a liquid form, a form in which state property was easy to put in one's own pocket. Instead of the expected increase of production efficiency the economic freedom has brought an almost countrywide production decline, there is no need to mention its effectiveness. A detailed analysis of this imbalance - economic freedom in underdeveloped institutions - can be found in the book of V.M. Polterovich (2008).

The two-layer economy instead of cooperatives and joint ventures under Gorbachev and the two-track economy at a turning point in 1991 are the historical alternatives which our country went past. It has already gone past. Now there is no need to lament over the missed opportunities. All the more, as they say, history has no subjunctive mood. What happened – that happened, and we need to learn the right lessons from it for the future.

While the debate about the benefits of “shock” and gradual ways to introduce market mechanism still continues. Moreover, there appear reputable treatises criticizing the “shocking” way in general, not only with regard to the transition from planned to market economies (see, for example, a sensational book “The Shock Doctrine: The Rise of Disaster Capitalism” by Naomi Klein (2009)).

1.9. Transitional economy

After the world was convinced, at least in part, that the present-day economy must still be based on market mechanism, the emphasis in the mixing of mechanisms had been changed. There was a notion of **a transitional economy**. It's such economy, which appears in the transition from the planned economy to the market one. It means that saving of the planned economy is out of the question, what is at issue is elimination of the planned economy and replacement of it by the market economy. Question: How does this mixed economy, called the transition economy, differ from a two-storied economy generated by the struggle with the shortcomings of the planned system? It differs in the fact that it is based on no longer the planned start but on the market start. At the beginning of the market

transition the market itself was not so much. But in most countries in transition including in Russia it was declared from the very beginning that the goal is a market economy. The exceptions were only China and the countries imitating it, for example Viet Nam.

Therefore, from an ideological point of view it would be appropriate to divide the transition countries into two types according to this feature, because it is decisive. In the meantime, it is accepted to divide the countries into those that follow the principle of “shock therapy” and those that follow the principle of gradualness or gradualism. It is clear that the speed of transition is a secondary feature, determined by the goal. To improve the planned system is one goal, to go over completely to a market economy is another goal. Therefore, the transition economy has led to the crisis in one case and to an accelerated development in another.

1.10. Double track economy in China and in Russia

We'll look more closely at the transition economy of the Chinese type. It is the economy that is called a double-track economy, sometimes a two-storied economy. Incidentally, in China it was possible to observe the phenomenon of two-storied economy, in a manner of speaking, literally. If you go into a big department store, for example in Beijing or Shanghai, you'll see that the essential commodities are mainly sold at low prices on the first floor. The higher you climb, the more expensive items you can see, while their variety and quality grow, the prices grow as well.

The double track economy had not received the recognition and any large-scale spreading in the Soviet Union, although some economists, including your obedient servant, wrote the notes to the higher authority, including Gorbachev, to establish the economy like that. But the first experiences were not bad. There was even semi-political movement which was called “two-storey economy”. The enterprises according to this movement remained as they were and they were not reformed. Their main task is to implement the plan. This is the first floor. And then you can

sell the production above the plan at the market prices. This is the second floor. It means that the plan as a stabilizing framework remained. And the market-based relationships developed on the second floor. There the population's demand was taken into account more exactly and subtly. There people pay money for their mistakes. There appeared a new type of investment accelerating the economic growth. But, of course, there could arise some crisis phenomena typical for the market economy. All these were realized in China accurately. Moreover, China has substantially improved the double-track economy (see, for example: Justin Lin, Fang Cai and Zhou Li (1996)).

1.11. More about cooperatives and double layer economy

How did the layering or the creation of two layers happen in the Soviet Union, and later in Russia? The cooperatives were set up within the enterprises, the cooperatives were the organizations with another type of property, namely private property. And this is nothing like stripping, looting businesses. The plan as an institution of stability was destroyed. The cooperatives didn't play a role of creators but they were a tool to transform the tangible assets into cash. This was the initial phase of large-scale crisis, which spread rapidly throughout the country.

Thus, the crisis of the planned economy or, more generally, the existing socialist system, was overcome due to the introduction of market mechanisms, and it led to two types of transition economy. The first one is a combination of planned and market beginnings into steady double-track economy. Another type, unstable by definition, is an accelerated establishment of market mechanisms accompanied by destruction of the planned institutions. No wonder that the second type led not to overcoming of the crisis but to its deepening and broadening.

1.12. The difference between the double track and two-layer economies

Now I'd like to say a couple words about the differences between the two-layer and double track economies. Sometimes these two economies are mixed. In fact, there are significant

differences between them. In the two-layer economy the players are institutionally homogeneous. They are state-owned enterprises divided into planned and market parts. It means that the border runs for each enterprise. In the double track economy there are two types of players with different targets and different controlled. The border separating the sectors is set in a natural way. You mustn't confuse the double track economy and the most common in the world mixed economy with the state and private sectors, and even producing private goods and public goods. The production of the latter is financed by the state, and therefore it can be considered as the second layer. You can stay here, taking into account that the transitional period has been written about so many and in different ways, with different estimates. Here we drew attention to the fact that when the soft part (economic freedom) becomes excessive, the crisis arises inevitably. So, the examples of the economy division into soft and hard parts show the natural way to strengthen the stability. In further discussion of social cluster society we'll consider a multilayer economy, however, only one layer remains a soft one - the market layer.

1.13. Isolation: Switzerland

So, here it is logical to make a pause in the discussion of various types of mixing of economic mechanisms as the most striking example of a combination of hard and soft beginnings, stabilizing society.

Now we turn to the isolation, the relative one, of course. A vivid example that immediately comes to mind is Switzerland. Surviving two world wars without serious losses, being almost in the epicenter of events - it is a striking phenomenon. And the basic explanation is the ability to stand aside, not to hamper anyone and to be necessary at the same time. As for the war the Swiss strategy proved to be extremely effective. However, this strategy didn't help to escape from the financial and economic crisis. In particular, the famous Swiss banks does not hurt less than others in the present crisis because they are fully involved in the world financial system.

1.14. Isolation: China

The isolation, the relative one, of course, from the world financial system are showed by China and the Muslim world with its Islamic banks, let alone Cuba and North Korea and, partly, Venezuela. We turn to China first. Yuan is known to be convertible currency only partially, and the conversion itself is under the complete control of the authorities. In addition, China actually has several currencies, they are understood in a wider sense. Namely: formally it is one currency – the Yuan, but the operations with it are not free, they depend on the specific circumstances and goals and they are governed by different rules.

For example, in the same way as in Russia, overflowing from the budget accounts into the commercial ones is prohibited; it is controlled by the Treasury. In China, there are several types of banks that operate by different rules. If the Russian long-term money is practically absent or generated directly by the target programs, in China there are banks, specifically aimed to finance the large projects that require long-term money. It means that we are dealing with several currencies, and it isolates the Chinese financial, particularly banking, system from the world one. I repeat, the matter is not about true isolation but about the creation of additional barriers, which significantly soften the blows coming from the global financial system. Some economists, let's call them the purists, imagine an ideal financial system as a protected one from any state interference where the means flow freely from one agent to another. Therefore, they blame the system of Chinese style in underdevelopment. Once it has barriers, it is imperfect. From my point of view, and from the standpoint of any mathematically minded individual, on the contrary, the ideal system, from their point of view, is only a special

case of a more general system. The Chinese have another special case, more flexible one, because it's easy to change the rules and still to get whatever version of the system.

In numerous discussions of anti-crisis measures, including at the level of "twenty", the majority agrees that the stimulation of domestic demand is an effective measure. China took advantage of this measure better than others, in particular, due to greater isolation.

1.15. Isolation: the Muslim world

Now about the Muslim world. It is known that the Muslim religion forbids the use of interest, so in this world there are prevailing banks that don't credit at an interest, they work on other technology, which is less prone to the influence of the global financial system. The Islamic banks lend out money for specific projects under very strict system of control. This is exactly what we need in a crisis. In other words, the Islamic banks are not prone directly to the financial crisis of the type that we are watching now. It does not mean that there are no shortcomings. There are some, but of another kind.

Specific statistics indicate that China and most Muslim countries show economic results, significantly better than the Western countries with lower degree of isolation.

1.16. Isolation of another kind

I'll mention here a different kind of isolation. Namely, the cultural, spiritual, historical identity, which every people, nation, civilization must preserve, maintain and develop. When using the term "identity", there is an image of some patriarchal and old-fashioned thing, although a curious one. This is a completely wrong idea about identity.

From the editorial staff: In subsequent chapters the author sets forth his vision of future society: this is a "federation" of equal social clusters (classes of new type), this federation uses the design economy as a leading economic mechanism.

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