Jeffrey Sachs and the Costs of Capitalism:
Economists, Economic Advisers, and Shock Therapy in Eastern European Transition Economies, 1985-1994

By
Adam Markovich

Thesis
Submitted to the Faculty of the
Department of History of Vanderbilt University
In partial fulfillment of the requirements
For Honors in History

April 2017

On the basis of this thesis defended by the candidate on 4/20/2017
we, the undersigned, recommend that the candidate be awarded HONORS
in History.

Director of Honors – Frank Wcislo

Faculty Adviser – Thomas Schwartz

Third Reader – Peter Rousseau

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Introduction

The mass and rapid transition from centrally planned communist economies to market based democracies in Eastern Europe that took place through the late 1980s to early 1990s was an extraordinary upheaval of rigid and complicated institutions so dramatic, that many world leaders and western experts thought it outright impossible only several years before these transitions began to occur. At the center of these changes were foreign economic advisers from the West, whose influence and economic opinions shaped the course of transition. Most notable among them was economist Jeffrey Sachs, who pioneered the practice of "Shock therapy" in post-communist transition systems in an attempt to encourage economic liberalism and instill the values of a free market democracy.

This thesis follows economist Jeffrey Sachs and his implementation of Shock Therapy in transition economies, examining the evolution of the practice while qualifying and contextualizing its effects. The goal of this analysis is to understand the evolution of the Jeffrey Sachs's thinking throughout his time as an economic adviser to foreign countries, and to contextualize his policies to recognize fairly where Shock Therapy succeeded and where it failed. In undertaking this consideration of how shock therapy is applied to these different historical environments, this thesis will explore the extent to which Sachs, and the policies he implemented, were sensitive to the history of the respective nations' culture, as well as their economic and political situations. It is not the goal of this thesis to provide counterfactual arguments to determine how outcomes could have differed, but rather to use these countries, along with this economist's policy suggestions, to create a case study concerning the foreign intervention in economic transition in Eastern Europe.

While shock therapy itself resulted in varying degrees of success and failure, its influence was both far reaching and long lasting in shaping the countries that would come out of the collapsing Soviet empire. This opportunity for an economist to participate in the creation of economic markets gave Sachs personally enormous power and influence in Eastern Europe, and as such subjected his implementation of Shock Therapy to analytical criticism. In order to understand this time of economic transition, the impact of this economist on transitioning economies, and how the evolution of different market contexts influenced the evolution of Sachs's views about shock therapy, certain materials are essential.

Due to the magnitude and importance of his economic advising at the time, Jeffrey Sachs had quickly become a prominent and internationally recognizable economist, with an extensive record of publications. His journal contributions and independently published papers are a critical source in understanding both the rationale behind his strategies, as well as how they evolved over time. His early publication, *The Bolivian Hyperinflation and Stabilization*, derives from the beginning of his career as a foreign economic consultant in the 1980s, and as the foundation for his method of Shock Therapy. [1] In this paper, Sachs justified the rapid releasing of price controls and state subsidies to spur trade liberalization as antidotes to mounting hyperinflation in Bolivia. Sachs argued against gradualist solutions to calm hyperinflation, reasoning that without an immediate end to unchecked currency expansion, collapse was imminent. Sachs identified areas where state subsidization of resources, especially oil, was propagating market inefficiency, and reducing the government's budget by trading inefficiently

[1] Sachs, J. D. (1986). The Bolivian Hyperinflation and Stabilization. The Earth Institute, Vol. 77, No. 2. Retrieved from http://www.earthinstitute.columbia.edu/sitefiles/file/about/director/documents/AERBolivia87.pdf

in world markets. As such, this paper outlines and justifies the methods for ending hyperinflation through proposals that later became the staple of his policy suggestions in Eastern Europe.

After his work in Bolivia, Sachs continued to advise national leaders throughout Latin America on their national reform strategies, mainly through his publications. In a contribution to a National Bureau of Economic Research Project Report, *Developing Country Debt and Economic Performance,* Sachs's volume, titled *Bolivia's Economic Crisis,* is a 9-chapter retrospective assessment of his hyperinflation and stabilization strategies in Bolivia.[2] It explored the economic results of his policies, and provided detailed justification for his proposals. Sachs emphasized the fiscal weaknesses that afflicted Bolivia at the time: immense budget deficits; price controls; and the policies from decades' prior that led to Bolivia's economic situation. With this background on Bolivia's political economy of macroeconomic policymaking, Sachs justifies and expounds upon his policy suggestions, as well as focusing on then contemporary causal links to hyperinflation.

Sachs brought this background and experience with him when he began his more well known consulting work in Eastern Europe, beginning with Poland. His earliest publication on Poland, co-authored with IMF economist David Lipton, was his "Summary of the Proposed Economic Program of Solidarity."[3] This 15-page document was his reform memo given to the Polish solidarity government in August 1989. Written at the request of Solidarity leader Jacek Kuron, this document, as far as Sachs recalls, was "the first attempt to write down a strategy and

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[2] Juan Antonio Morales and Jeffrey D. Sachs, "Bolivia's Economic Crisis," in *Developing Country Debt and the World Economy*, ed. Jeffrey D. Sachs (Chicago: University of Chicago Press, 1989)
[3] Sachs, J.D., Lipton, D. (1989, August 18). Summary of the Proposed Economic Program of Solidarity. Retrieved from
http://www.earthinstitute.columbia.edu/sitefiles/file/about/director/documents/Poland%20Reform%20Memo.pdf

timetable for the dismantling of a centrally planned economy and its replacement by a market economy."[4] This memo was the blueprint that Solidarity ultimately utilized for its transition.

With Sachs's official appointment as an economic adviser to Poland's new Solidarity government, he gained international media attention, and wrote extensively in many contemporary news sources. His publications such as "What is to be done?" in the Economist, and "How to Help the Solidarity Government Succeed" in the Financial Times serve to characterize his initial framework for tackling Poland, and are excellent sources to compare to what his policies ultimately became in Poland.[5][6] The language and rhetoric of these publications also provides more nuance in Sachs's arguments that are not found in his academic scholarship. In contrast to these publications, contemporary news articles also provide both support and criticisms of his plans by economists and political scientists alike, helping to understand the climate surrounding his policy decisions.[7][8]

Potentially Sachs's best presentation of his argument for the rapid transformation of Poland's economy, comes from his book "Poland's Jump to the Market Economy."[9] The published version of his Robbins Lectures given at the London School of Economics in 1991, is Sachs's most comprehensive explanation of his policy plans for Poland. Going beyond the economic theory normally present in his publications, Sachs goes to great lengths to explain the historical and cultural aspects of Poland that influenced his approach to their transition.

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[4] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/

[5] Sachs, J.D. (1990, January 13) What is to be done? The Economist

[6] Sachs, J.D. (1989, September 26) How to Help the Solidarity Government Succeed. Financial Times

[7] Risen, James. "Cowboy of Poland's Economy : Ah, to be 35, American and Solidarity's most influential adviser. Jeffrey Sachs and his critics alike agree it's downright scary." *Los Angeles Times*, February 9, 1990. http://articles.latimes.com/print/1990-02-09/news/mn-248_1_jeffrey-sachs

[8] Weschler, Lawrence. "A Grand Experiment." *The New Yorker* (New York), November 13, 1989. http://jeffsachs.org/wp-content/uploads/2015/07/The-New-Yorker-_-Nov-13-1989.pdf.

[9] Sachs, J.D. (1994). Poland's Jump to the Market Economy. Cambridge, MA: MIT Press.

Published after his involvement in Poland, this work, when compared to his initial reform memo, presents changes in his economic thinking, specifically on the issue of privatization, that explores the evolution of Shock therapy as a practice.

Following his use of Shock Therapy in Poland, Sachs's next advising role took him to Russia. With mass corruption and conflicting opinions surrounding the events of Russia's transition, Sachs's writings are critical in understanding how he thought of his work at the time, as well as how he later justified his attempts during his role as an economic adviser. His *What I did in Russia,* written almost two decades after his work in Russia, treats the "considerable misunderstanding of [his] role as an economic adviser in Russia in the early 1990s."[10] Sachs attempts to explain the failures of Russia's economic transition, while divorcing himself of responsibility for it. In conjunction with other works, and as this thesis will later explore, Sachs's role in Russia ultimately did prove to be minimal; however, these failures still have implications for the effectiveness of Shock Therapy as a practice. Because this work was published so far after his involvement in Russia, his recollections require corroboration and verification. As such, the newspaper contributions Sachs made during his time in Russia, such as his personal views published in T*he Financial Times,* will stand to corroborate his accounts and opinions as he remembers them in this work.[11]

Several publications on the transition in Eastern Europe in general provide data and analysis of Poland and Russia, especially as compared to the rest of eastern Europe. Lucjan Orlowski's "*Transition and Growth in Post-Communist Countries: The Ten-Year Experience"* combines papers by economists, including Sachs, who were a part of planning the transition for

[10] Sachs, What I did in Russia.
[11] Sachs, J.D. (1994, March 31) Personal View – Russia – IMF Gives Too Little Too Late, Financial Times.

some Eastern European countries, with commentaries and critiques by other contemporary economists to provide more insight into the reasoning behind economic decisions.[12] The commentary provided in the work also sheds light into the popular thinking at the time of foreign economic advisers, and as such, is partly reflective of the prevailing economic approaches to handling these transition markets. By looking at transition after a decade of different efforts throughout Eastern Europe, these papers also provide commentary on the individuating factors within certain countries. The diversity of these countries, along with their unique economic situations, qualify cases where there were dramatically different outcomes in countries that implemented similar policies, such as the differences between Poland and Russia. While predominantly focusing on economic analysis, this work also provides a reflection on the political transformations in a majority of the countries examined. Provided in relation to the economic changes such as social reformation, this political contextualization helps to better color the overall transition for these individual countries, and frames the economic recommendations and suggestions in a broader environment.

Thesis Outline

This thesis comprises of three chapters, each following Sachs's involvement as a foreign economic adviser to a Bolivia, then Poland, and finally Russia. The first Chapter will focus on Sachs's work in Bolivia, but not before defining Sachs's background as an economist. Considering his influences, along with popular economic theory of the time, this chapter will begin by characterizing his ideas to give a foundation to describe their evolution over time. This chapter will introduce Shock therapy, providing Sachs's own definition and comparing it to that

[12] Orlowski, Lucjan. "Transition and Growth in Post-Communist Countries: The Ten-Year Experience" Edward Elgar xviii, 2001.

of other economists. Understanding how Sachs viewed his role as a foreign adviser is essential. Following these sections, analysis of his work in Bolivia will begin with a brief background contextualizing Bolivia's hyperinflation crisis, with the bulk of this chapter will examine Sachs's policies, qualifying their results.

The second chapter will focus on Sachs's work as a foreign economic adviser to Poland. A brief background contextualizing Poland's economic crisis will lead into analysis of his policy suggestions. The chapter emphasizes the Balcerowicz plan, the successes and difficulties of Poland's attempts at privatization, and the ensuing ramifications of this mishandled policymaking. This chapter will also focus on divorcing some of the credit for the successes and failures of Poland from Sachs, by highlighting where his suggestions were either ignored or outright rejected. Specific attention will also be paid to Sachs's success in generating foreign aid and economic assistance for Poland, which will contrast heavily with the situation in Russia in Chapter 3.

The final chapter will focus on Sachs's advising in Russia. This chapter will also begin with a brief background into Russia's economic situation to contextualize Sachs's policy suggestions. Because a vast majority of Sachs's policy suggestions ultimately were not followed by the then new Russian government, attention will be paid to analyzing the corruption present in the Russian reform efforts that did take place, and explaining the circumstantial problems that Sachs faced when trying to implement Shock Therapy. Specific attention will be paid to the lack of foreign aid, as compared to Poland and Bolivia, as well as internal corruption of both the Russian government, and Sachs's economic team.

This thesis will attempt to fit into the existing literature on the Eastern European transition, as well as literature on Shock Therapy itself, by following the work of economist

Jeffrey Sachs, and qualifying his successes and failures when attempting to implement this type of economic strategy in transition markets. As it stands, a great deal of study is not only still young, but focuses heavily on the comparative situations between transitioning economies; to look at the winners and losers in the transition and to then ask what caused their disparities. It is my goal with this thesis to contextualize these efforts, as well as explain the evolution of Sachs's own policy suggestions, to conceive more clearly the thought process, and the politicking behind the economic policies that ultimately shaped these transitions.

Chapter One: Creating Shock Therapy

In understanding the implementation of shock therapy in the context of the Eastern European transition, an initial exploration of the origins of the idea, its historical influences, and its initial implementation in Bolivia are in order. Additionally, as Jeffrey Sachs was the main architect of the practice, the economic schools of thought that influenced his policymaking, as well as the development of his methods over time will be evaluated. Exploring the responsiveness, and evolution of Sachs, both as an economist and policy adviser, is imperative in understanding juxtaposition between the policies implemented in Poland and Russia, as well as their outcomes. As such, this chapter will serve to provide the groundwork for Sachs as an economic thinker, a basis for understanding shock therapy as a concept, and its implementation in Latin America, to contextualize the practice as it made its way to the then crumbling Soviet Bloc.

Shock Therapy: Ideological Backgrounds and Defining the Practice

Shock therapy itself has several interpretations and definitions, that vary with competing economic schools of thought, and the scope of the policies that fall within it. Sachs admitted that "[he] never picked the phrase… it was something that was overlaid by journalism and public discussion" and that he did not much like it.[1] Often, Sachs preferred calling his policy suggestions, "stabilization programs" in order to avoid the negative connotations that shock

[1] Sachs, Jeffrey D. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. June 15, 2000. http://www.pbs.org/wgbh/commandingheights/shared/minitext/int_jeffreysachs.html.

therapy later acquired. Sachs however, has never denied that he indeed was a practitioner of shock therapy. What Sachs does dispute is the definition of the practice itself.

On the one hand, Sachs later reflected that shock therapy simply referred to the "dismantling of all government intervention in the economy in order to establish a "free-market" economy" and as such, is synonymous with neoliberalism.[2] Believing a view especially embraced by the media an oversimplification that ignored the context of specific conditions, Sachs regarded a pure "free-market" economy as nothing more than "textbook fiction, [and] not a practical or desirable reality."[3]On the other hand, Sachs preferred a definition of shock therapy that emphasizes the immediate end of price and currency controls and withdrawal of state subsidies spent on inefficient industries. As Sachs notes, one important element of this market liberalization is the free international convertibility of a country's currency to promote international trade.[4] While Sachs remembers this to be the form of shock therapy he implemented, this definition does not include any mention of privatization efforts, a problem Sachs wrestled with heavily in both Poland and Russia. While Sachs later claimed that in Russia "[his] area of responsibility for advising was macroeconomics, not privatization" it's clear that, because of the corruption and scandals surrounding its implementation, Sachs was divorcing himself of responsibility. While this thesis will explore the validity of his justifications for doing so, these were key issues in Eastern Europe's transition, and as such, most definitions of shock therapy include privatization.[5]

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[2] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/

[3] Ibid.

[4] Ibid.

[5] Sanchez de Lozada, Gonzalo, Moises Naim, Jeffrey D. Sachs, Leszek Balcerowicz, Yegor Gaidar, Mikhail Gorbachev, and Joseph Stiglitz. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. June 15, 2000. http://www.pbs.org/wgbh/commandingheights/shared/minitext/ufd_shocktherapy.html.

To Sachs's own credit, the first definition of shock therapy was misrepresentative of his work, as will be explored later in this thesis, and was portrayed habitually by media reports covering his work. Often claiming that Sachs, for better or for worse, was rallying for a new Marshall Plan, media accounts during his advising, and those more contemporary still, characterized his work as "peddling a… free-market ideology."[6] Against this, Sachs claimed his intentions were never to build an entire free market economy, but to help transition countries' economies, specifically Poland and Russia, and reintegrate them both into the rest of Europe.[7] While free market economies obviously did spur from his involvement, Sachs argued that this was a consequence, more than the goal, of his stabilization programs. As he later recalled on his work in Poland, "I was never to create a free-market economy, since such a free-market economy does not exist in Europe. Poland's goal was to become a normal country in Europe."[8]

Before his work as a macroeconomic adviser to governments in crisis, Jeffrey Sachs was nothing short of an academic prodigy. Specializing in monetary theory and international finance at Harvard University, Sachs passed his general exams for the Ph.D. in economics while still in college. Invited to join the Harvard Society of Fellows while still a graduate student, Sachs officially joined the Harvard faculty in 1980, and in only two years was awarded tenure at the age of 28. [9] In an interview with PBS, Sachs admitted on his economic origins that he "grew up intellectually at Harvard" describing himself as leaning more towards being a student of Keynes

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[6] Cassidy, John. "Always With Us?: Jeffrey Sachs's plan to eradicate world poverty." *The New Yorker*, April 11, 2005. http://www.newyorker.com/magazine/2005/04/11/always-with-us.
[7] Ibid.
[8] Sachs, What I did in Russia.
[9] Passell, P. (1993, June 27). Dr. Jeffrey Sachs, Shock Therapist. The New York Times. Retrieved from http://www.nytimes.com/1993/06/27/magazine/dr-jeffrey-sachs-shock-therapist.html?pagewanted=all

and not of Friedman.[10] Ironically, it was Friedman who was heavily involved with, and coined the term "shock policy" for Chile's economic reform in 1975, where Sachs would draw heavy inspiration.

Sachs admitted that his economic schools of thought shifted throughout his practical work as an economic advisor. While still a Keynesian, Sachs often rejected contemporary economic treatment of Keynes's work. "Economists, spoiled by a bastardization of Keynes, often talk as if all you had to do is turn a dial marked "economic growth.""[11] Furthermore, Sachs was very critical of the removal of economists from the practical world, and while highly published himself, looked down upon the isolationist tendencies of his contemporaries and the ivory towers they confined themselves within. As Sachs put it, "I do not believe in the life cycle model that says an economist ought to be isolated and insulated until age 60. I know I get better at this having confronted real problems."[12] As is clearly evidenced by his work, Sachs went to great lengths to put his ideas to practice, however to the extent that he understood the economies he was to grapple with, will be explored further in this thesis.

Upon his initial arrival in Bolivia, Sachs later recalled that he brought with him several economics papers, all outlining the successful ends of inflation periods of the 20th century, some as decisively as ending within a day.[13] As the Bolivian Minister of Planning Gonzalo Sanchez de Lozada remembered, "at that time … people felt you couldn't stop hyperinflation in a democracy; that you had to have… an authoritarian government… depriving people of their civil

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[10] Sachs, Jeffrey D. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. June 15, 2000. http://www.pbs.org/wgbh/commandingheights/shared/minitext/int_jeffreysachs.html.
[11] Nasar, Sylvia. "Three Whiz Kid Economists of the 90's, Pragmatists All." *The New York Times* (New York), October 27, 1991. http://www.nytimes.com/1991/10/27/business/three-whiz-kid-economists-of-the-90-s-pragmatists-all.html?pagewanted=all.
[12] Ibid.
[13] Ibid.

rights and … violating human rights." While this chapter will later explore the extent to which Bolivia avoided violating civil rights, shock therapy's successful and immediate quelling of hyperinflation was undoubtedly a fundamental rethinking of methodology, and of hyperinflation itself. Therefore, understanding hyperinflation is essential in understanding why Sachs promoted shock therapy as its combatant.

Of the two main types of hyperinflation models, Sachs's work is most heavily understood through the lens of the monetary model. Hyperinflation, most simply, is a rapid and uncontrolled increase in both the money supply, and the velocity of money. In the monetary model, hyperinflation is perceived as a positive feedback loop of rapid monetary expansion. Governments print more of their currency to pay spiraling costs, and run their deficits further and further without proper fiscal policies in place to stabilize the currency. As was the case in all the countries Sachs worked in, price controls and subsidies were the root cause of hyperinflation, whether through failing industry or major resources being priced below world prices. Under this model of hyperinflation, businesses (or in the case of Poland and Russia, international businesses) perceive the rapid currency expansion, and mark up prices to cover the expected reduction in value of the currency. Issuers of currency continually respond with accelerating their expansion to cover the higher prices, and further push down their currencies value. As Sachs came to find, in this model, the only solution is to stop expanding the currency. What distinguished Sachs from his contemporary economists was in his approach, to end currency expansion as abruptly as possible. The immediate end of monetary expansion, as Sachs conceived it, would always result in a financial shock, hence the popularization of the term shock therapy.

Bolivian Beginnings

While Jeffrey Sachs could have remained a distinguished academic, in July of 1985 his career took a sudden but decisive turn towards the practical when a former student invited him to make suggestions about how to solve Bolivia's mounting hyperinflation problem.[14] Before the end of the year, Sachs went on to become the adviser to the newly elected president Victor Paz Estenssoro.

At the time of Sachs's intervention, Bolivia was not only the poorest country in South America, but its hyperinflation had climbed to an almost unbelievable 24,000 percent annual rate.[15] The general consensus among economists at the time was that there was no conceivable way to stabilize prices without triggering a devastatingly large recession. The young and confident Jeffrey Sachs not only proved them wrong, but went on to lay the groundwork for tactics that he would later implement in Poland during their transition to a market economy.

At the forefront of Sachs's plan for Bolivia was a seemingly counterintuitive fiscal action; Sachs called for a massive increase in the price of petroleum products sold by state-owned enterprises to the public. At the time sold at roughly one-tenth of world market prices, oil was heavily subsidized by the government.[16] While the low gasoline prices benefitted the upper and middle class of Bolivia, this undercutting of world prices contributed dramatically to the country's hyperinflation. Bolivia's poorer citizens disproportionally felt the burden of hyperinflation by the loss of value of the paper money they used in transactions. Furthermore, this extreme subsidy encouraged the smuggling of vast quantities of petroleum products

[14] Sachs What I did in Russia.
[15] Ibid.
[16] Sachs, J. D. (1989). New Approaches to the Latin American Debt Crisis. Essays in International Finance, (174). Retrieved from https://www.princeton.edu/~ies/IES_Essays/E174.pdf.

purchased in Bolivia and into neighboring Peru.[17] The ultimate source of Bolivia's hyperinflation however, was its large budget deficit, which was entirely financed by the central bank's careless and unfettered money printing habits.[18] Closing the budget deficit decisively, as Sachs's plan argued, was the only means by which hyperinflation would end quickly and without major consequence.

While Sachs later suggested to Poland the idea of temporarily pegging their currency to the U.S. Dollar, in Bolivia he did the opposite. On August 29, 1985, under Sachs's advising, the Bolivian government announced a free exchange rate for the peso.[19] Earlier that year the Bolivian government had devalued the peso from 75,000 per US dollar to one million per US dollar, in order to find relative stability.[20] With this free exchange rate, the peso saw an even larger devaluation of 95 percent, causing its value to reach an astonishing low of 2.2 million per US dollar.[21] In order to support the peso Sachs had the Bolivian government buy pesos in international markets with their foreign exchange reserves. While the peso eventually saw appreciation thanks to this endeavor, Bolivia's patience was running thin.

While Sachs himself has described Bolivia's undertaking of his suggested measures as "peace[ful] and under democratic, constitutional rule"[22] this is not entirely accurate. At the very start of emergency measures, a constitutional state of siege was declared in response to mass

[17] Sachs, J. D. What I did in Russia.
[18] Ibid.
[19] Sachs, J. D., & Morales, J. A. (1989). Bolivia's Economic Crisis. The National Bureau of Economic Research, 57-80. Retrieved from http://www.nber.org/chapters/c7520.pdf
[20] Sachs, J. D. (1989). Social Conflict and Populist Policies in Latin America. The National Bureau of Economic Research, (2897). Retrieved from http://www.nber.org/papers/w2897
[21] Ibid.
[22] Sachs, J. D. What I did in Russia.

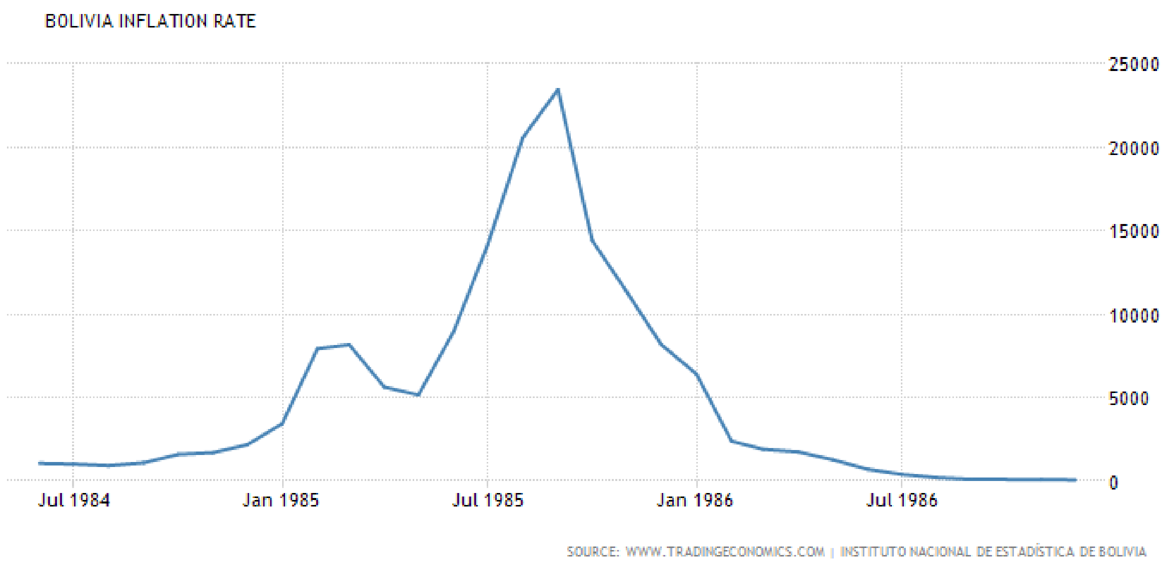
worker strikes and protests.[23] Obviously Sachs's decision to raise oil prices by a factor of 10 and devalue the peso by 95 percent, essentially overnight, was no standard practice, but this shock to the economy had caused thousands of Bolivians, especially those from The Bolivian Workers Central, to reject such radicalism and refuse to cooperate. With half of the nation's state mines effectively shut down, the government responded by sending in the military.[24] On September 18th, 1985, fearing insurrection, the Bolivian government rounded up hundreds of labor leaders and sent them to internment camps in the Bolivian tropics.[25] This constitutional state of siege ran on for 90 days, and while interned citizens were released and constitutional rights were restored, Bolivia still stood divided. To Sachs's credit, however, the country's combative hyperinflation was beginning to change, and the benefits of such dramatic measures were on the horizon.

As the higher oil prices drew down Bolivia's hyperinflation, Bolivia's budget was still far from under control. While debt servicing was in suspension at the time Jeffrey Sachs began advising Bolivia, by early 1986 the IMF began to insist that Bolivia should resume their debt-service payments. Initially recommending that the Bolivian government continue to default on external debts, Sachs sternly objected to this increase in international pressure. As Sachs saw it, "any resumption of debt service payments would kill the stabilization program and throw Bolivia back into hyperinflation."[26] Leading the negotiations with the IMF and international banks, Sachs was able to take advantage of the fact that the principle of debt reduction was not yet

[23] McFarren, P. (1985, December 18). Government Ends State of Siege, Restores Rights. Associated Press. Retrieved from http://www.apnewsarchive.com/1985/Government-Ends-State-of-Siege-Restores-Rights/id-f300961ce55a9982e2514d19e526be69
[24] Zuazo, A. (1986, September 1). Bolivian President Seeks Support for State of Siege. United Press International. Retrieved from http://www.upi.com/Archives/1986/09/01/Bolivian-president-seeks-support-for-state-of-siege/9933525931200/?spt=su
[25] McFarren, P. Government Ends State of Siege, Restores Rights. Associated Press.
[26] Sachs, J. D. What I did in Russia.

established in international circles, and after months of tense negotiation was able to settle Bolivia's mountain of debt to international lenders for roughly 11 cents on the dollar.[27]

Figure 1.1 Bolivia's Inflation Rate (July 1984-July 1986)



In the spring of 1986, Bolivia's next emergency measure came in the shape of tax reform. Strong opposition came from large landowners who would, for some, be facing taxation for the first time.[28] While the reformation of the tax system was important for Bolivia's economic future, Sachs played no substantive role in this process because, as he saw it, "this was the government's fight, not [his]."[29] Sachs had come to Bolivia as a macroeconomist, with a short-term assignment to help quell hyperinflation, and not as a long-term development advisor. In fact, it is this experience in Bolivia that Sachs admits would reorient him towards long-term development issues.[30]

[27] Sachs, J. D. (1986). The Bolivian Hyperinflation and Stabilization. The National Bureau of Economic Research, (2073). Retrieved from http://www.nber.org/papers/w2073.pdf
[28] Sachs, J. D. What I did in Russia.
[29] Ibid
[30] Ibid.

While Sachs only served as an economic adviser to Bolivia from July 1985 to the end of 1986, a brief 18 months, his influence in the geographical region continued to grow over the following years. With the international community impressed by his success in tackling hyperinflation in Bolivia, Sachs was invited by national leaders throughout Latin American to discuss reform strategies. From 1987-1989 Sachs met with government leaders in Argentina, Brazil, Ecuador, Venezuela, and he would even write a book of recommendations for Peruvian economic reforms, while continuing a self-described role of "part-time advising" for the Bolivian Government.[31]

[31] Ibid.

Chapter Two: Jeffrey Sachs and the Polish Transition

Introduction

From 1970-1980, Edward Gierek, as first secretary of the Polish United Workers' Party (PZPR) led Poland to massive borrowing and debt in an attempt to modernize Polish industry. His "New Development Strategy" was based on import-led growth.[1] This economic program essentially was based on large-scale borrowing from western banks in order to essentially buy the technology necessary to upgrade Poland's exports. These western banks, mainly from the United States and West Germany, would ultimately be owed over $ 24 billion US (1970s) by the end of Gierek's reign, something that his administration would be unable to pay back.[2]

Gierek's economic model was proximately dependent on global economic conditions remaining relatively stable in order to succeed. Thus, when the early 70s began a worldwide recession and increased oil prices, Poland came to find itself in trouble. The 1973-74 oil crisis created mass inflation, and then recession in the West, which led to sharp increases in the price of imported consumer goods in Poland, and a decline in demand for Polish exports. As economic inefficiency and overall Polish debt rose, Gerek's administration did not change their approach.[3] Thus, as new factories were built, basic market demand and cost effectiveness was being ignored, and the benefits that technological improvements can normally have on a developing economy did not materialize in Poland.[4]

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[1]Jane Hardy (2009) Poland's New Capitalism, Pluto Press, pp. 19–20
[2]Poland – The Historical Setting: Chapter 6: The Polish People's Republic. Polish Academic Information Center, University at Buffalo. Retrieved from http://info-poland.buffalo.edu/classroom/longhist6.html
[3]A brief history of Poland: Chapter 13: The Post-War Years, 1945–1990. Polonia Today Online.
[4] David Ost (1990) Solidarity and the Politics of Anti-Politics, Temple University Press pp. 55–58

These growing economic difficulties ultimately led to an increased dependence on the Soviet Union. In February of 1976, the Polish constitution was amended to formalize their “unshakable fraternal bonds” with the Soviet Union, essentially seen by many as a display of submissiveness.[5] While the regime felt it needed the additional authority of the Soviet Union to back up their credibility in light of their indebtedness and mounting economic crisis, this amendment was by far the most contentious change to their constitution yet and resulted in heavy political opposition that would grow to create the groundwork for organizations like the Solidarity Movement. [6]

By 1980, the Polish economy had spiraled out of control, and policymakers were beginning to face difficult choices, with no right answers. Western bankers providing loans to the Polish government made it clear in July of 1980 that the state could no longer subsidize low prices of consumer goods.[7] Without the subsidies that were held their fragile economy in place, Polish leaders knew their end would spark a worker rebellion. Strikes and protests grew rapidly, and ultimately the Solidarity movement was born. The Gdańsk Agreement would come only a month later, which acknowledged the right of employees to have unions, increased the minimum wage, improved and extended welfare and pensions, and ultimately weakened the rule of the Party.[8]

Solidarity, officially a national labor union, started as a non-political movement aiming to rebuild civil society. It ultimately lost much of its labor focus and become a major political force in Poland through the next few years. As Poland’s economic situation continued to deteriorate,

[5] Pełczyński, Zbigniew A.(1980). "Chapter 16. Poland under Gierek". In Leslie, Robert Frank. The History of Poland since 1863. Cambridge, England: Cambridge University Press. pp. 431–432.
[6] Andrzej Leon Sowa, Historia polityczna Polski 1944–1991 [The Political History of Poland: 1944–1991], pp 405–407.
[7] "Poland May Just be the Beginning," Fortune magazine, December 1, 1980
[8] Davies, Norman (2005). God's Playground, a History of Poland: 1795 to the Present. Columbia University Press. pp. 482–491.

the government and Solidary representatives would begin discussions that would only end in disagreements.9

With Gierek already removed from office in September of 1980 and replaced with Stanislaw Kania, the PZPR's economic policies did not improve. Kania would then be ousted in favor of Wojceich Jaruzelski in February of 1981. In light of the nation's economic deterioration and in an attempt to crack-down on Solidarity, Jaruzelski declared Martial Law on December 13th 1981. Lasting until July 22nd 1983, this attempt to crush political opposition would only further harm Poland's economic vitality, as their crisis grew to be even more pronounced than under Gierek's administration.10 While debt had skyrocketed to $24 billion by 1980, it would increase to $40 billion under Jaruzelski.11 Jaruzelski's government would respond to their increasing debt by maintaining a highly artificial exchange rate with Western currencies, which resulted in a growing black market and the development of a shortage economy.12 Poland's economy was reaching rock-bottom, and with it, Solidarity began to reemerge. By 1989 there was positive signs of substantive change, as roundtable talks between leading parties gave way to Solidarity's participation in the 1989 election. While the communist party-coalition wasted time with internal

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[9] Domber, Gregory (2014) *Empowering Revolution: America, Poland, and the End of the Cold War (The New Cold War History).* University of North Carolina Press.

[10] Andrzej Godlewski, Dudek: I do not believe that Jaruzelski defended us against the Red Army, a conversation with Antoni Dudek. 13 December 2010. Polish daily www.polskatimes.pl.

[11] Hufbauer, Gary Clyde; Jeffrey J. Schott; Kimberly Ann Elliott (1990). Economic Sanctions Reconsidered: History and Current Policy. Institute for International Economics. pp. p. 193.

[12] Jackson, John E; Jacek Klich; Krystyna Poznanska (2005). The Political Economy of Poland's Transition: New Firms and Reform Governments. Cambridge University Press. pp. p. 21.

feuding, the Solidarity candidates were heavily promoted, and as a result, Solidarity leaders assumed control of the government. 13

Poland and the Sachs Plan

After his work in Latin America, Sachs became an international sensation in the press. Hailed as the “Indiana Jones of economics” his picture and writings were featured everywhere from Newsweek to the LA Times, always with regular reminder of his promotion to full professor at Harvard when he was only twenty-nine.[14] Thus, when Poland began to look for new solutions to their immense debt problem, this western economist, whose 18-month Latin American expedition successfully drove down Bolivia’s hyperinflation and debt, certainly made their radar.

In January 1989 the Polish communist government had reached out to Jeffrey Sachs, initially with the hopes that he could just advise them on the management of their external and monstrous $40 billion debt. At the time, Sachs claimed that he initially declined this offer, because he did not want to work with the current communist government.[15] With Solidarity still outlawed, Sachs later remembered that at the time he had explained to the Polish government that if and when Solidarity would become legalized he would come both as an adviser to the

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[13] Ash, Timothy Garton. *The Magic Lantern: The Revolution of ’89 Witnessed in Warsaw, Budapest, Berlin, and Prague*. Vintage, 1999.
[14] Risen, James. "Cowboy of Poland's Economy : Ah, to be 35, American and Solidarity's most influential adviser. Jeffrey Sachs and his critics alike agree it's downright scary." *Los Angeles Times*, February 9, 1990. http://articles.latimes.com/print/1990-02-09/news/mn-248_1_jeffrey-sachs
[15] Weschler, Lawrence. "A Grand Experiment." *The New Yorker* (New York), November 13, 1989. http://jeffsachs.org/wp-content/uploads/2015/07/The-New-Yorker-_-Nov-13-1989.pdf.

Government and the Solidarity movement.[16] It was only when Solidary Movement was legalized in early April 1989, that Sachs began work in Poland.

Arriving in Warsaw on April 5th, the day of the signing of Poland's Roundtable Agreement that legalized Solidarity, Sachs met with Solidarity's economic team. Sachs worked closely with Dr. David Lipton, sent by the IMF, and by May, the two had constructed a request for aid from Western governments, that was known as the "Brussels Project" of Solidarity.[17] The first of many requests for Western aid, Poland saw little success on this front, with contributors like the U.S. initially proposing hardly one-tenth of what was requested.[18]

Although Sachs was working with other economists, namely Dr. David Lipton, he had far more influence, at least in his own mind, than any other foreign economist. In an interview with the LA Times he admitted as much, saying "There are other people (economists) there, and some of them are actually offering useful advice, but no one else is as close to the [Solidarity] leadership."[19] With this in mind, during the months of June and July, Sachs claims to have had "extensive discussions" with the Solidarity leadership, urging them take advantage of the June 4th elections and "organize the next government, the first post-communist government in Eastern Europe."[20] This type of political involvement went far beyond Poland's initial request of economic advising, and yet according to Sachs's further depictions, his politicking was undoubtedly part of the nature of their relationship.[21]

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[16] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/
[17] Ibid.
[18] Bush, G. H., & Scowcroft, B. (1998). A World Transformed. New York: Knopf. pp. 110
[19] Risen, James. "Cowboy of Poland's Economy"
[20] Sachs, J. D. What I did in Russia.
[21] Ibid.

When a new Polish parliament with its Solidarity majority convened in early June, with the success of its restructuring, Sachs now received the invitation to move from the debt restructuring favored by the communists to a full-fledged market transition favored by Solidarity. Jacek Kuron, a newly elected member of Poland's lower house, and a larger embodiment of Solidarity's egalitarian ethos, became Sachs's champion. Along with the editorial board of *Gazeta Wyborcza*, the national newspaper of Solidarity, Kuron successfully persuaded Sachs to formalize his economic plan for Poland, almost overnight, and present it to leadership in July.[22] As Sachs later recalls, the timing was urgent;

> "Poland was in the throes of revolutionary change from one-party dictatorship to a new democracy. The economy was collapsing. Solidarity was negotiating with the Communist leaders and indirectly with the Soviet leaders as well. The Solidarity leaders needed an economic plan in order to move forward politically as well as economically. Kuron's request resulted in this overnight plan."[23]

Sachs later testified, that this was the key document that first set forward his strategy and timetable for transitioning a centrally planned economy into a market economy.[24] In this document Sachs called for the immediate ending of subsidies and price controls, the stabilization of currency through fixing exchange rates to the US dollar, and outlined the creation of a private sector economy, among other policy suggestions.[25] This blueprint for Sachs's plan was first shared with Solidary leadership in July, and later disseminated through to the Solidarity-led Senate Commission on economic reform, through testimony in the subsequent months.

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[22] Wiener, Jon. "Chapter 7: Capitalist Shock Therapy: The Sachs Plan in Poland." In *Professors, Politics and Pop*, 49. London: Verso, 1991

[23] Sachs, J. D. (2015, April 13). Poland's First Economic Reform Plan of July 1989. Retrieved from http://jeffsachs.org/2015/04/polands-first-economic-reform-plan-of-july-1989/

[24] Ibid.

[25] Sachs, J.D., Lipton, D. (1989, August 18). Summary of the Proposed Economic Program of Solidarity. Retrieved from http://www.earthinstitute.columbia.edu/sitefiles/file/about/director/documents/Poland%20Reform%20Memo.pdf

However, the first internationally public presentation of the plan would come in August 1989, when Sachs spoke before the Polish Parliament on the day of their installation as Central Europe's first post-communist government. Sachs shared the podium with then-U.S. Senate minority leader Robert Dole, whose attendance symbolized American support for the new government of Poland.[26] In Sachs's passionate speech to Parliament, he explained how he had ended Bolivia's 24,000 per cent inflation rate, as he claimed, overnight. Sachs claimed that Poland needed "the same kind of shock therapy," a phrase that ultimately became brand name for his entire economic approach in the country.[27] He argued that, because Poland's inflation was only one-twentieth of what Bolivia's had been a few years earlier, their prospects of success were excellent.[28] With the same gumption and confidence, Sachs went on to outline the structure of how he would ensure Poland's rapid transformation to a market-based economy, echoing the ideas he'd already written in his reform memo. At the same time, Sachs urged the Solidarity leadership to abandon any ideas of attempting to move towards "market socialism" as he saw this to be a "dead end."[29]

One of the most important aspects of Sachs's speech, entirely independent of his actual economic proposal, was the rhetoric he employed to describe it. He argued that Poland had a natural place as a member of Western Europe. As such, Sachs coopted the slogan of Poland's revolution, "the Return to Europe" and applied it to his own economic reform package.[30] In this way, Sachs was incredibly unique in both his position within the government, and how he operated outside of its normal boundaries. Sachs even admitted months later that what he was

[26] Ibid.
[27] Wiener, Jon. "Chapter 7: Capitalist Shock Therapy: The Sachs Plan in Poland."pp 49.
[28] Ibid.
[29] Sachs, Jeffrey D. *Poland's jump to the market economy*. Cambridge, MA: MIT Press, 1994. pp. 31
[30] Ibid.

doing was “unusual professionally.”[31] As an economic adviser, Sachs had up to this point, never had any practical experience with Eastern bloc economies; and yet here he stood, not only christening Central Europe’s first post-communist government, but very publically, with the United States’ representative beside him, advising the direction of their future actions. Regardless of any opinion on his economic proposals, it’s clear that Sachs’s role as an “economic adviser” was much larger, and more politically involved, than the title normally suggests.

How exactly Sachs came to this point is also worth exploring. At the time, Polish specialist at the University of Maryland, Bartek Kaminski, speculated that for many Poles, having a Harvard economist working with Solidarity had given the plan “a seal of approval.” He also added that “many of the Polish economists working with Solidarity had always felt that a radical approach was needed… But nobody dared formulate it in such a way before.”[32] With Jeffrey Sachs, it’s possible that the plan he proposed, along with his Western background, gave weight to the legitimacy of ideas Polish economists had already been warm to. Balcerowicz later argued as much when he claimed

> “…it made us more confident that people from abroad like Jeff Sachs, like David Lipton, like Jacek Rostowski or Stanislaw Gomulka, were working with us, because as I said, I was absolutely sure that going slowly would condemn us to failure, but that radical option is risky. [But] that is better than hopeless. It is risky, so to have outside advisors who were helping with working out crucial details was also psychologically important.”[33]

With international acclaim, Jeffrey Sachs was the perfect physical manifestation of a return to the West for Polish citizens. That said, it’s clear with this speech, as would continue to be the

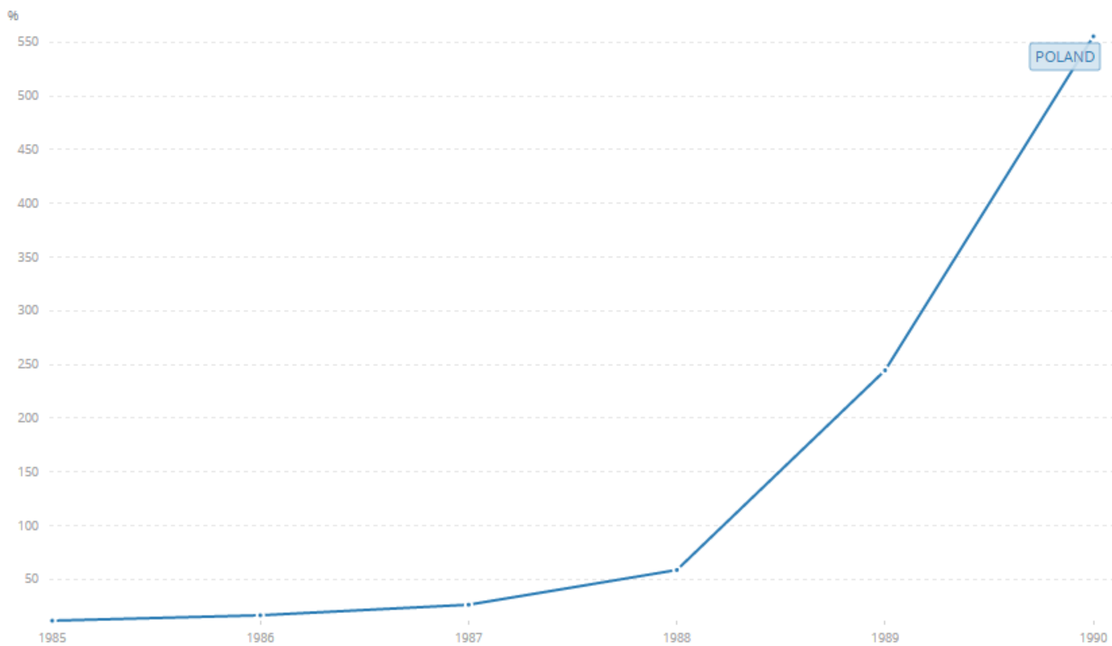
[31] Risen, James. "Cowboy of Poland's Economy”
[32] Ibid.
[33] Leszek Balcerowicz. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. November 12, 2000.

case, that Sachs was not just a tool for the Polish government, but a driving force whose will would be imposed upon all of Poland.

Central to Sachs's thinking was debt relief for the Polish state. The new Solidarity government had inherited the side effects of their communist predecessor's bad lending habits, all producing hyperinflation. By the end of the year, Poland's inflation was approaching nearly 600%, increasing 10-fold from the beginning of 1988.[34] Poland's hyperinflation also had an important and peculiar characteristic. Normally, in market economies, a monetary expansion produces a broad-based increase in prices. In Poland, however, as Sachs explained, "price increases in most sectors were blocked by official controls on prices, administered by the ministry of finance."[35] Thus, in these sectors, the former communist government's bad spending habits and their price controls produced shortages and queues on "official" markets, and increased resort to black markets, wherein prices soared. As Sachs concluded, "the Polish hyperinflation was a mix of open inflation and repressed inflation, with soaring black market prices and a growing resort to illegal trade and barter."[36]

[34] IMF Data, Inflation, consumer prices (annual %)
[35] Sachs, J.D. (1994). Poland's Jump to the Market Economy. Cambridge, MA: MIT Press. p 36.
[36] Ibid p 37.

Figure 1.2: Poland's Inflation Rate (1985-1990)



[37]

With massive shortages, and risks of panic, the Solidarity government's concerns loomed beyond just depravation and depression, but towards the possibility of a Soviet crackdown.[38] While it would appear that this sense of urgency could be a strong justification for Sachs's radical, but fast acting, economic suggestions, it's important to understand that Sachs had already visited Moscow for a conference, hosted by Gorbachev's adviser Abel Aganbegyna, on soviet economic reforms earlier in April, and was in good standing with some of Gorbachev's advisers.[39]

Sachs's initial plan consisted of following main points. First, as with the name Shock Therapy, Sachs advocated for an immediate opening of the economy for international trade through the removal of import and export liscencing and by granting private enterprises an

[37] IMF Data, Inflation, consumer prices (annual %)
[38] Sachs, J. D. What I did in Russia.
[39] Ibid.

"automatic" right to import and export.[40] The reasoning behind this marketization effort, as Sachs proposed, was to relieve the shortages of consumer and producer goods, and to begin to establish competition in Poland's basic industries, by allowing capital to flow freely into, and out of Poland. This international trade would also modify the existing price structures for most basic goods.[41] Up until now, price structures had been bureaucratically set, with heavy subsidization of certain industries present as well; because of this, as Sachs argued, opening markets would essentially "import" price standards into Poland, and thus, with competitive world prices, attract foreign direct investment.[42] In Sachs's view, this would be the first step in the integration of Poland into, what he called, the "Western European economic area."[43]

In the second plank of his plan, in accordance with marketization, Sachs also proposed the creation of a fixed exchange rate between the zloty and the US Dollar.[44] This, relatively common macroeconomic tactic, was an attempt to guarantee the value of the zloty internationally, encouraging foreign investment. In Sachs's third point, he called for the mobilization of large-scale support from the West.[45] In both his speech and memo Sachs was particularly vague on defining what this would look like, only calling for the procurement of "informal discussion" with the IMF, World Bank, and "official creditors."[46] Framed as a means to facilitate stabilization without positing excessive hardship on Poland, Sachs later remembered his emphasis on ensuring the consolidation of democracy as a key goal of this point.[47] With U.S. representative Robert Dole sharing the podium, it's clear that Sachs was very much aware of the

[40] Sachs and Lipton, Summary of the Proposed Economic Program of Solidarity
[41] Ibid.
[42] Sachs, J. D. What I did in Russia.
[43] Ibid.
[44] Sachs and Lipton, Summary of the Proposed Economic Program of Solidarity
[45] Ibid.
[46] Ibid.
[47] Sachs, J. D. What I did in Russia.

politics that surrounded his situation, and was, in a multitude of ways, taking advantage of his position and the influence it bequeathed him.

What Sachs failed to mention in his memo and speech to parliament, however, was the issue of privatization of major state-controlled industries. Sachs later admitted that his early recommendation lacked this detail, as he claimed that the reason behind this omission was that he had not yet formulated the strategy for tackling this issue.[48][49] Sachs later estimated that it would take several years, "perhaps around five" to complete.[50] The issue of privatization of major state-controlled industries posed a large problem for Poland's economic reconstruction, and as such, this omission stands as a mistake on Sachs's initial planning.

Questions arise as to whether Sachs, as an economic adviser acting in good faith, should have been more forthright with this issue, as he should have known the conundrum undoing decades of subsidized industries would cause. Sachs was no longer acting as an adviser in the same capacity as he did in Bolivia, wherein he had a single goal, to quell hyperinflation, and was not involved in long term economic development planning. As Bartek Kaminski cautiously noted a few months later, "[Sachs] didn't seem to be fully aware of the institutions in a Communist country and the implications they have for [his] stabilization program."[51] Stopping inflation in a third world country is very different from sparking economic growth and competition in a country that had not competed on international markets since 1945. Sachs strategically omitted this issue from his speech. because of the international pressures within a room, from which he

[48] Ibid.
[49] In fairness, it's also important to note that, given Jacek Kuron's request that Sachs and Lipton have this initial document prepared to be presented to Polish Leadership by July, it's possible that this could have rushed planning and thus not given Sachs enough time to tackle this issue by the time he was asked to present his plan before Parliament in August.
[50] Ibid.
[51] Risen, James. "Cowboy of Poland's Economy"

was still attempting to secure aid packages. In any case, this issue would cause unemployment to skyrocket and would be a defining part of recession Poland would fight at the start of the next decade.

The Balcerowicz Team

On August 24th,1989, Sachs had his first meeting with Prime Minister Tadeusz Mazowiecki. There, Sachs claims to have suggested the need for Poland to adopt "rapid and decisive economic reform measures."[52] Mazowiecki, in response, felt that he needed to find his "Ludwig Erhard," and he found him in Dr. Leszek Balcerowicz.[53] Balcerowicz was an economics professor at the Warsaw Institute of Economics, as well as chairman of two different Warsaw institutes.[54] While nowhere near Sachs's level of academic pristine, Balcerowicz graduated from the Foreign Trade faculty of the Central School of Planning and Statistics in Warsaw in 1970, and later pursued his MBA at St. John's University in New York City, before returning back to Poland for his doctorate in 1975.[55] In 1978 Balcerowicz created an informal economics centered think-tank which grew in popularity over time, and after August 1980 was called the "Balcerowicz Group."[56] Initially, the proposals coming out of this think-tank were focused on working within the political constraints under Poland's then-communist regime, to attempt to improve efficiency by introducing more competition. After martial law was imposed in December 1981, the Balcerowicz Group's reforms became more radical, and suggestive of

[52] Sachs, J. D. What I did in Russia.
[53] Mazowiecki was referencing the famous German politician and Minister for Economics, Ludwig Erhard, who was responsible for the construction of Germany's postwar economic reforms. These reforms were bold and led to significant economic recovery, often called the "Wirtschaftswender" or "economic miracle."
[54] Hunter, Richard J., Jr., and Leo V. Ryan, C.S.V. "The March to the Market Economy: 1989-1993" in *From Autarchy to Market: Polish Economics and Politics, 1945-1995,* 73-104. Westport, CT: Praeger, 1998. pp 84.
[55] Ibid.
[56] Ibid.

fundamental economic restructuring.[57] This group's economic reform ideas had not only been debated for years prior to Solidarity, but had garnered enough publicity as to influence the Mazowiecki and Solidarity governments. Balcerowicz, thus, was a natural choice for Mazowiecki, and he was then named deputy prime minister and minister of finance in September 1989.[58]

Sachs and Lipton met with Balcerowicz early the same month, and joined as advisers. From September 1989 to January 1, 1990, the Balcerowicz team worked to prepare the outline of an economic program that, based on the same principles Sachs had been advocating, called for rapid stabilization and immediate marketization. Sachs contended at the time five main pillars of this reform – macroeconomic stabilization, liberalization, privatization, construction of a social safety net, and mobilization of international financial assistance.

The Balcerowicz Plan is a decisive and radical break from the communist system designed to force Poland to "jump to the market economy".[59] Before the month was out, the team had already prepared a memorandum for circulation in Washington at the annual IMF/World Bank meetings. It sought support for the radical efforts Mazowiecki's government was prepared to undertake for economic stabilization.[60] Sachs and Lipton personally visited Washington with Balcerowicz to oversee these meetings, as the team continued to look for support from creditor nations like the United States, West Germany, England, and France.[61]

Sachs was key in formulating this international assistance strategy. In a three-page memo to the IMF, which was also published publically in the *Financial Times,* he laid out the four main

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[57] Ibid.
[58] Ibid.
[59] Ibid pp 85.
[60] Sachs and Lipton, Summary of the Proposed Economic Program of Solidarity
[61] Hunter, and Leo. *From Autarchy to Market: Polish Economics and Politics, 1945-1995,* 73-104.

components of Poland's international requests.[62] First, Poland required a continuation of the suspension of their debt servicing, along with a partial cancellation of their $40 billion debt burden. Sachs argued first that the Solidarity government of Poland was technically a new government, and as such, should not be beholden to the debts of the old one. More bluntly, Sachs dismissed the idea of the new government paying off their huge debt and any attempt to collect it at face value would subject Poland to "economic serfdom for the next generation."[63] Second, he asked for the creation of a $1 billion Zloty stabilization fund from major countries, in order to provide Poland with reserves enough to back the currency in order to break hyperinflation.[64][65] Third, the international assistance strategy required IMF loans equivalent to 700 million $US and 500 million $US from The World Bank.

The debt cancellation plan was especially controversial; so much so that as Sachs later recalled that, "policymakers in the U.S. Government and Bretton Woods institutions told Polish officials that the ideas were dangerous and unrealistic and warned them not to listen to [him.]"[66] IMF officials were also opposed the Zloty stabilization fund, citing, according to Sachs, that the funds requested would be impossible to raise.[67] In order to remedy this, Sachs lobbied American leaders, such as Senator Robert Dole, National Security Adviser Brent Scowcroft, in order to attempt to explain and justify the request for these funds.[68] Whether or not Sachs's in person conversations with international representatives did anything to affect the outcome of the

[62] Sachs, Jeffrey. "How To Help The Solidarity Government Succeed; Aid For Poland," memo, September 26, 1989. http://www.earthinstitute.columbia.edu/sitefiles/file/Sachs%20Writing/1989/How%20to%20Help%20the%20Solidarity%20Government%20Succeed%20-%201989.pdf

[63] Wiener, Jon. *Professors, Politics and Pop*, 52.
[64] The money Sachs was asking for was not the equivalent of $1 billion in USD in Polish currency, but rather $1 billion Zloty.
[65] Ibid.
[66] Ibid.
[67] Ibid.
[68] Ibid.

situation, the U.S. Government eventually did endorse the proposal, along with other countries, so that the Zloty stabilization fund had been successfully sponsored by the launch of Poland's reform programs.[69]

On New Year's Day, 1990, Poland finally committed to what Sachs had been calling for from the beginning and "brought to a sudden and harsh end the nation's ossified system of price controls and other subsidies."[70] Their adoption a new economic reform package "shocked" the economy in what was ultimately an attempt to force market capitalism onto the collapsing Communist system.[71] The plan that had just been implemented, called the Balcerowicz Plan, was a decisive and radical break from the communist system which forced Poland to "jump to the market economy."[72] Make no mistake with the title of the plan however, Sachs contended at the time that the five main pillars of this reform - macroeconomic stabilization, liberalization, privatization, construction of a social safety net, and mobilization of international financial assistance to support the process – were his.[73]

In more concrete terms, the package consisted of the following five major components:

1. A restrictive monetary policy was implemented, supporting a drastic reduction of the money supply, the establishment of a high interest rate, and a new law introducing interest rate adjustments in <u>all</u> previous credit agreements.[74]
2. Drastic reductions in subsidies for food, raw materials, energy carries, production inputs, as well as removing tax exemptions in order to drawn down the budget deficit.[75]

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[69] Ibid.
[70] Risen, James. "Cowboy of Poland's Economy"
[71] Ibid.
[72] Hunter, and Leo. From Autarchy to Market: Polish Economics and Politics, 1945-1995, pp 79.
[73] Ibid. pp. 85
[74] Ibid. 86
[75] Ibid. 86

3. Liberalization of prices, as well as significant increases in prices that were still under government control (such as fuel and energy, and transportation.)[76]
4. The zloty was made pegged to a single exchange rate of 9,500 zlotys per 1 USD. Along with the elimination of many import quotas and most export quotas.[77]
5. A restrictive income policy was introduced wherein the general wage indexation that was formerly used in the state enterprise sector would be eliminated.[78] Severe tax penalties on wage increases in the state sector were also introduced.[79]

These components were represented by 10 "acts" within the Balcerowicz plan, which were signed into being December 31st 1989, and implemented the next day.[80] The plan would be translated into law over the next two years. Perhaps even more significant is understanding what is missing from this plan. The privatization strategy was not agreed upon at the start of the Polish reform effort. Sachs later contended that the main focus of the plan initially was on stabilization, liberalization, and integration with the European Community, and not on handling the privatization of major state-controlled industries. Left unresolved was finding a way to safely get rid of these inefficient industries, and force the very notion of private ownership onto Poland.[81] The debate over this issue began to intensify in the middle of 1990, and Sachs ultimately proposed the idea of National Investment Funds (NIFs) in an attempt to strike some level of compromise.[82] This program of funding was an attempt at creating private ownership as well as providing what Sachs called "adequate corporate governance" for large corporations.[83] In many

[76] Ibid. 86
[77] Ibid. 86
[78] This policy was partially introduced earlier in July 1989
[79] Ibid. 86
[80] Sachs, J. D. What I did in Russia.
[81] Ibid.
[82] Ibid.
[83] Ibid.

respects, this gradual approach to blending in privatization was the opposite of Shock Therapy. Implemented slowly and limitedly, and ultimately with a good deal of controversy this proposal, Sachs later reflected, played a modest role in Poland's privatization and was "not necessary to the success of Poland's reforms…" He even went so far as to speculate that "it [was] probably a good thing in the end that [NIFs] were not adopted on a large scale."[84]

The NIFs are relevant however, as a marker of the difficulties reformers faced in Poland's privatization efforts. It points out a first attempt to wrestle with privatization. At the forefront of Poland's "jump to a market economy," there was very little understanding of how to make that jump. This became Poland's largest problem for the next few years. As it entered an economic recession, which was admittedly predicted by Sachs and the Balcerowicz team, as a necessary burden of their plan, the duration of the shock into a years-long recession became subject to debate.

The Outcomes of Deindustrialization

Over the 1990s, the majority of Eastern European economies fell into a colossal post-communist recession.[85] If neoliberal reform promised a quick recession, most Central Eastern European countries still had not returned to their 1989 levels of economic output by 2002.[86] Poland was the exception. Sachs's premise that short-term hardship promised long-term proved correct in the long term, but sudden liberalization, as predicted, bankrupted many soviet-led companies that were inefficient, and costly, although their magnitude initially was greatly

[84] Ibid.
[85] Orenstein, Mitchell. *What Happened in East European (Political) Economies?: A Balance Sheet for Neoliberal Reform*. Johns Hopkins University, 2009. p 5.
[86] Ibid. p 6.

underestimated. As it would turn out, the deindustrialization in Poland was greater than in other European, including post-communist countries. Thousands of companies, especially those that had been oriented toward the Soviet and COMECON (Council for Mutual Economic Assistance) markets were completely bankrupted, as they were forced to compete with Western firms. More than one third of all large and midsize industrial assets were harshly eliminated. [87]While global competition, initially, was thought to promote economic prosperity, in the case of Poland, limited market experience and western technological superiority proved to demolish most businesses, and thus reoriented trade. 90 percent of trade shifted from East to West within two years, shutting down a great deal of enterprises with it.[88]

By 2000, Poland would reach 127 percent of its 1989 economic level of GDP, a feat almost none of its neighboring transitionary countries would come close to.[89] Poland's achievement of having the highest rate of GDP growth, along with the smallest increase in inequality is most specifically attributed to the unique roots of Poland's Solidarity government, and their inherent focus on workers' rights. Against the advising of Jeffrey Sachs, the Polish government funded an enormous amount of social spending, using as much as 16 percent of its GDP on pensions alone in the mid-1990s.[90] Through these generous and well-targeted system of social transfers, the government was able to mitigate the rise in income inequality that occurred

[87] Polish Industrial Lobby. *Losses in the potential of Polish Industry and its Lame Transformation after 1989. The vision of a modern Polish re-industrialization*. 2012. p 13.

[88] Orenstein, Mitchell. *What Happened in East European (Political) Economies?* p 5.

[89] Ibid. p 6.

[90] Ibid. p 7.

in other Central Eastern European countries during their transitions, and instead was able to facilitate enterprise restructuring and other market-oriented reformation.[91]

Despite a steadily increasing GDP, Poland faced growing unemployment. Poland's unemployment rate was low initially, at only 0.3 percent in January of 1990, just after reforms began. By the end of the year it would rise to 6.5 percent.[92] While Sachs promised a short-term recession, the unemployment rate would continue to rise steadily, peaking at 16.9% in 1994. Poland's rapid privatization also came with drawbacks in its execution specifically. 23 percent of all assets transferred in the privatization of institutions came from hostile takeovers. This normally happened where industrial entities were sold and then changed to the service sector, or liquidated in order to facilitate a takeover of the old company's market by buying the firm.[93][94] This issue most likely arose due to lack of oversight and supervision concerning international acquisitions, however it's clear that Sachs's plan never accounted for this. Moreover, about one third of assets transferred also came from land speculation.[95][96] With this in mind, some economists have gone so far as to argue that only 25-30 percent of Poland's deindustrialized reductions were economically justified. One reason for this harsh economic assessment comes from Poland's elimination of some arguably competitive markets. Electronic, telecommunication, computer, industrial machinery, armament, and chemical industries were all

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[91] Keane, Michale, and Prasad, Eswar. *Poland: Inequality, Transfers, and Growth in Transition*. Finance and Development, Vol. 38, No. 1. 2001.

[92] Polish Central Statistics Office, Unemployment rate 1990-2013.

[93] Soroka, Paul. *Poland after 1989. Experienced Industrial Disaster. Can We Rebuild our Potential?* Forsal, 2015.

[94] In most cases, the firms bought were typically foreign

[95] Soroka, Paul. *Poland after 1989. Experienced Industrial Disaster. Can We Rebuild our Potential?* Forsal, 2015.

[96] It's important to note that land contributes such a large amount of Polish assets as, at the time, about 60 percent of Poland's total area was agricultural land. (Poland Agricultural Census 1990.) http://www.fao.org/fileadmin/templates/ess/documents/world_census_of_agriculture/main_results_by_country/Poland_1990.pdf)

eliminated as a result of the rapid flooding of cheap imports from the West and the Far East into the Polish market, despite being relatively competitive geographically.[97] While it could be argued that this would be a natural drawback to shock therapy, exceptions were made elsewhere. With respect to the privatization of the state sector, Sachs chose to take more gradualist approaches, delaying the privatization of state-owned enterprises, and thus giving society time to handle the divestiture.[98] While Sachs's efforts with state-owned enterprises were successful, its odd that these other industries went unprotected.

Ultimately, while the GDP growth coming out of the mid 1990s leads many to suggest that Sachs's plan for Poland was a success, the evaluation of Poland's economic advancement particularly depends on the criteria used. Poland suffered large amounts of uncontrolled unemployment despite its rising GDP, and while they are comparatively more fortunate than most of their neighbors in how smooth their transition was, that still comes with the opportunity cost of killing off many potentially competitive markets. Furthermore, aspects of Poland's rising GDP can be attributed directly to policies that Sachs did not encourage, such as enormous social spending. In this light, the amount of credit we can assign Sachs for the outcomes seen in Poland becomes limited.

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[97] Soroka, Paul. *Poland after 1989. Experienced Industrial Disaster. Can We Rebuild our Potential?* Forsal, 2015.
[98] Lipton, D., Sachs, J., Fischer, S., & Kornai, J. *Creating a Market Economy in Eastern Europe: The Case of Poland.* Brookings Papers on Economic Activity, 1990.

From Russia with Love

Introduction

Immediately following his roughly two-year engagement with Poland, Sachs rotated to Russia in late 1991 in order to attempt to emulate the seemingly successful transformations already beginning in Eastern Europe. The situation he was walking into, however, was vastly different than anything he'd faced before. Russia had built an economy that lived off of cheap oil resources that were running dry and exporting at plummeting prices, and accrued tens of billions of dollars in foreign debt, with its creditors beginning to ask for repayment. As Sachs put it, "Gorbachev probably didn't understand a lot of it, but I'm not sure that any of us understood the full enormity of the problems."[1]

Soviet Russia's immense wealth of natural resources, especially oil, were the backbone of its economy. Following the 1970s energy crisis, the world oil economy went into an "oil glut."[2] A serious surplus of crude oil, caused by falling demand. This immense devaluation put oil-producing countries, like the Soviet Union, in worsening financial vice. The resulting six-year decline in the price of oil plunged more than half its valuation in 1986 alone.[3] Russia was initially able to survive this market deterioration by borrowing from creditors abroad, but with world prices never yet reaching their pre-1980 levels, Russia's foreign credits were drying up

[1] Sachs, Jeffrey D. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. June 15, 2000. http://www.pbs.org/wgbh/commandingheights/shared/minitext/int_jeffreysachs.html.
[2] Hershey Jr., Robert D. (1981 June 21). "How the Oil Glut Is Changing Business". The New York Times.
[3] Hershey Jr., Robert D. (1989, December 30). "Worrying Anew Over Oil Imports". The New York Times.

quickly. Jeffrey Sachs argued that it was this ensuing balance of payments crisis that played a large role in the overall Soviet collapse.[4]

Figure 3.1: World Crude Oil Prices (January 1980- January 1991)

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With oil production and revenues being a vital source of budget income and foreign exchange for Russia, these plummeting prices spelled ruin. By the time Sachs became involved, Russia was already entering into an acute external debt crisis, as a result of their heavy borrowing in the latter portion of the 1980s. While Poland familiarized Sachs with inefficient industries, a massive proportion of Soviet industry was producing at "negative value added," meaning at world market prices their revenue was net negative. The USSR was losing money by subsidizing these industries on a scale much vaster than Poland.[6] With 15 republics, roughly 150 million people (five times the population of Poland) and spanning over 11 time zones, Russia's

[4] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/
[5] Adjusted for inflation, set to current world prices in $USD
[6] Sachs, J. D. What I did in Russia.

economic issues were orders of magnitude larger in scale and diversity than what Sachs had previously worked with. And the country was beginning to fall apart.

Sachs Meets Russia

With Poland, making international headlines for the radical nature of their new economic policies, mastermind Jeffrey Sachs was naturally under the watchful Soviet eye. From 1985-91 Gorbachev's administration had practiced gradualist reforms, trying to inject more moderate free market reforms under a four-year plan, with no success.[7] With Mikhail Gorbachev's economic advisers now harshly divided between gradualists and radicals, Polish reform became a beacon for the latter to assert their voice, and as such, economist Grigory Yavlinsky was sent to Poland in early 1990 to observe this experiment.

Yavlinsky at the time was head of the Joint Economic Department of the Government of the USSR and, after looking into Poland and meeting with Sachs, committed to the notion of rapidly transitioning from a centrally planned economy to a free market. While Yavlinsky was surveying the Polish economic landscape beginning in early 1990, he didn't formally meet Jeffrey Sachs until the fall, visiting him in the United States where they discussed the practicalities of potentially applying radical reform in the Soviet Union. With that, Yavlinsky attempted to telex a favorable report on Poland back to the Kremlin, only to have it blocked by the Soviet Ambassador in Warsaw.[8] This bad omen, of internal conflict to come, did not deter him however, and Yavlinsky assembled a team of young, likeminded soviet economists authoring the "500-day plan" in mid-1990. This plan, while never ultimately implemented,

[7] Song, Keunwon. "Four Reformers in Russia's Shock Therapy: Insufficient and Incompetent External Help & the Lack of Internal Political Consensus and Control." Vestnik: The Journal of Russian and Asian Studies, April 4, 2016. http://www.sras.org/shock_therepy_russia_fail.
[8] Sachs, J. D. What I did in Russia.

ambitiously called for the creation of a competitive market economy, mass privatization, and a large transfer of power from the Union government to the Republics, all within 500 days.[9] While Gorbachev was very skeptical of this report, it gained immediate support from soon to be president of the emerging Russian Republic, Boris Yeltsin.

After their meeting, Sachs agreed to provide "whatever support [he] could" to Yavlinsky's reform efforts, and as such, chronicles his work with Russia as informally beginning under Gorbachev in the fall of 1990.[10] By spring of 1991, completely aware of Gorbachev's skepticism towards his 500-day plan, Yavlinsky decided to design a new economic reform package, this time with more explicit help from Western thinkers. A Harvard-based project, led by Yavlinsky, Graham Allison of the Harvard Kennedy School of Government, and including Jeffrey Sachs, produced a "Grand Bargain," a synthesis of international cooperation to facilitate democratization.

Published in the summer 1991, this package aimed to utilize large-scale infusions of Western financial and technical aid to facilitate democratization and economic reformation of Russia. [11][12] In this work Sachs offered what at the time was considered to be a notoriously high estimate for the amount of aid the Soviet Union, and the later successor republics, would require. Envisioned as grants and highly concessional loans (below market rate long-term loans), he estimated $30 billion annually over five years, or $150 billion in total would be needed. [13][14]

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[9] I͡Avlinskiĭ, G., & Kushner, D. S. (1991). *500 days: Transition to the Market*. New York: St. Martin's Press.
[10] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/
[11] Allison, G. T., & Javlinskij, G. A. (1991). *Window of opportunity: the grand bargain for democracy in the Soviet Union.* New York: Pantheon Books.
[12] The United States was the main target of this effort.
[13] Sachs, J.D. (1991, May 28). "Soviet Reform and the West," *Financial Times*. http://jeffsachs.org/wp-content/uploads/2012/03/Soviet-Reform-and-the-west.pdf
[14] Accounting for inflation this would be roughly $280 billion today

While Gorbachev signed on to this plan the west did not, and in early July 1991 the G7 in Houston flatly denied the Soviet request for aid.[15] This refusal began a trend of rejected financial support requests that continued even after the fall of the Soviet Union, and as Sachs later suggested, "likely contributed to the timing of the attempted putsch (coup) against Gorbachev in August of 1991."[16] Ultimately, neither Gorbachev's presidency, nor the Soviet Union would last the year.

While Gorbachev was still the President of the Soviet Union, on July 10th Boris Yeltsin began his term as the President of the Russian Soviet Federative Socialist Republic (RSFSR). This newly created position later transformed into the presidency of today's Russian Federation. Initially one of Gorbachev's supporters, Yeltsin, after the perestroika reforms, grew to be one of his most powerful political opponents. While Gorbachev was still the President of the Soviet Union, Yeltsin's was President of Russia and this made him the de jure leader of the RSFSR. With that he had full control over Russia's economic reform.

Sachs and his plans for the Russian Transition

A supporter of shock therapy Yeltsin initially seemed the perfect fit for Sachs's advising. In October 1991, Sachs was informed that Yegor Gaidar was likely to head Yeltsin's economic team and that they were planning to have Russia launch radical market reforms "with or without the rest of the Soviet Union."[17] With Russia's political, and now economic division from the Soviet Union garnering traction, the break-up of the Soviet Union was becoming much more conceivable. That said, according to Sachs, the Bush administration at the time was still dealing

[15] R. W. Apple Jr. (1990, July 12) "The Houston Summit; A New Balance of Power," The *New York Times.*
[16] Sachs, J. D. What I did in Russia.
[17] Ibid.

"almost exclusively" with the Soviet Union, and as such, Gaidar's emerging economic team had little to no contact with the rest of the world officially.

Yegor Gaidar, a long time academic, free market advocate, and a supporter of shock therapy, made the perfect companion for Sachs. When Sachs was invited by Gaidar to help with the planning of economic reforms, he agreed immediately. Days after Gaidar had officially come to power as the head of Yeltsin's new economic team, the G-7 deputies came to Moscow urging the Soviet Union to continue to service their external debts. Given Sachs's history of debt cancellation in Poland, he not surprisingly argued that the G-7 nations and the Bush administration in the lead lacked "realism… about the extreme desperation of the economic scene."[18] With inflation running at roughly 30 percent per month and rising, Sachs's position is not entirely unfounded.[19] With their back against the wall however, Russia continued to service its debts for the next few months while Sachs and Gaidar worked to devise an economic strategy, with Sachs in particular focusing on the problem of the IMF's lack of compassion.

In early December 1991 Jeffrey Sachs's role as an external economic advisor to the Yeltsin administration became official, and he met with Yeltsin in that capacity at two meetings, on December 11th and 13th that gathered together a team of foreign economic advisers. In these meetings, Sachs remembers Yeltsin as "extremely coherent and engaged", qualities that would later become absent in him, according to Sachs.[20] In an astonishing moment, as remembered by Jeffrey Sachs, Yeltsin began the latter meeting with the announcement that he had reached an

[18] Ibid.
[19] Sachs, J. D. (1993, January/February). "Strengthening Western Support for Russia," *International Economic Insights*, Vol. IV No. 1. http://www.earthinstitute.columbia.edu/sitefiles/file/about/director/documents/jrliei0193.pdf
[20] Sachs, J. D. (2012, March 14). What I did in Russia. Retrieved from http://jeffsachs.org/2012/03/what-i-did-in-russia/

agreement with the Soviet military leadership concerning the dissolution of the Soviet Union.[21] In these meetings, Sachs recalled being the spokesman for all of the external advisers present, as he laid the groundwork for the reform tasks facing Russia.

Reform priorities Sachs outlined were A. the immediate liberalization of markets, and B. the establishment of the infrastructure to facilitate open trade. This plan began, as it did in Poland, with the elimination of price controls, strong fiscal policies aimed at maintaining a low budget deficit, and tight monetary policies. Most importantly however, was still the issue of Western aid. This time, given how unpopular his previous request for aid was, Sachs repackaged his proposal utilizing a $5 billion stabilization fund, with $15 billion of assistance in the form of grants and long-term concessional loans. This plan however would require "deep debt relief from the inherited Soviet-era debt."[22]

In framing the debate over reform strategies, Sachs held seven main positions. First, he advocated, as he had previously in Poland, for the immediate and unanimous elimination of price controls, in order to liberalize and create free markets. Second, was reducing the money supply and ending federal subsidies to firms in order to stabilize prices and eliminate inefficient industries, albeit with the understood cost of initial unemployment. Third was the promotion of social safety nets, funded with the help of Western countries along with the IMF and World Bank, to minimize the short term harms of transition. Fourth, in line with promoting safety nets, Sachs also called for large-scale foreign assistance, in the form of grants and concessional loans, from these same institutions, and in a similar fashion to what was currently underway in Poland. Fifth, Sachs pushed for commercialization of Russian enterprises, taking state industries and

[21] Ibid.
[22] Ibid.

turning them into corporations with state ownership, rather than just private entities. Sixth, was promoting a quick, but "transparent privatization" with an emphasis on preventing corruption. Lastly, in a first hint of what Soviet conditions would impose on his thinking, Sachs supported continued state ownership of large natural resource corporations, the prime source of Russian wealth. He argued that this would ensure that the Russian government controlled revenues from its natural resources, as well as prevent monopolization and corruption in these large economically crucial industries. With the exception of the elimination of price controls and execution of corporate commercialization, none of these recommendations were ultimately enforced.[23]

At the same time, Sachs was beginning to look at the problem of privatization. While he later disingenuously contended that he only had "a tangential role in the plans for privatization of major industries," in late 1991, Sachs worked with Anatoly Chubais, the incoming head of the State Property Commission, on privatization strategies. Sachs's colleague Andrei Shleifer, a Russian-born Harvard professor of economics, was the foreign adviser who worked most closely with Chubais on privatization. Sachs had later come out against Shleifer's approach, claiming that it was "quick and reckless" and contributed to corruption, however Sachs, as will be examined later in this chapter, did arguably have the influence to affect privatization policy if he chose to utilize it.[24]

On December 26th, 1991, the Soviet Union officially dissolved and by January 2nd, Gaidar, now the 1st Minister of Finance of Russia, could implement a decisive end to price controls. Sachs, acting as an advisor on Gaidar's economic team, argued in support of this

[23] Ibid.
[24] Ibid.

decision that Russia “move to markets based on supply and demand, or it would face devastating shortages… with massive black markets and corruptions.”[25] While there was a one-time jump in price levels (because the price controls were suppressing inflation) arguably, this policy eased what could have been extreme shortages.[26] Unfortunately, Russia’s economic transition would never work this smoothly again.

Advising in Russia: Sachs gets Snubbed

By February 1992, only a few months after the G-7 deputies had visited Moscow and forced Yeltsin to continue debt payments, Russia had completely run out of money. Since December of 1991, Sachs had been working with the IMF to reach a middle ground on Western assistance for Russia, but there was hardly any to be found. Between 1992 and 1999, the IMF gave Russia a total of $22.7 billion.[27] It is far less than Poland, who received $42.3 billion during their transition period.[28] Furthermore the IMF’s delivery of aid was disorganized and left Russia without the ability to rely on, or even accurately predict, the aid it could utilize year to year.

[25] Ibid.
[26] Ibid.
[27] Song, Keunwon. "Four Reformers in Russia's Shock Therapy”
[28] Ibid.

Table 3.1: Official Financial Assistance to Russia, 1992-1993

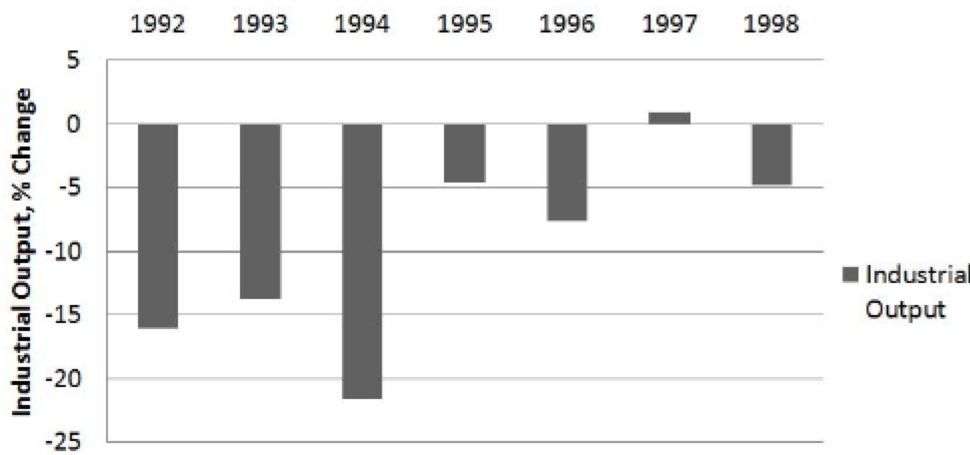
	1992		1993		1992–93	
Assistance	*Announced*	*Delivered*	*Announced*	*Delivered*	*Announced*	*Delivered*
IMF	9.0	1.0	13.0	1.5	14.0	2.5
World Bank and EBRD	1.5	0	5.0	0.5	5.0	0.5
Bilateral[a]	13.5	14.0	10.0	6.0	21.0	20.0
Export credits		12.5		5.5		18.0
Grants		1.5		0.5		2.0
Total	24.0	15.0	28.0	8.0	40.0	23.0
Memorandum items						
Aid from international agencies	10.5	1.0	18.0	2.0	19.0	3.0
Budgetary support[b]		0.5		2.0		2.5

a. Includes $2.5 billion of promised relief on interest payments that was not formally granted in 1992.
b. Estimate of aid directly in support of budgetary financing, not counting debt rescheduling (see text).
Source: Based on IMF press release, February 1, 1994, with author's estimates of "budgetary support." [29]

Incredibly critical and frustrated with these policies, as far as Jeffrey Sachs was concerned, the IMF had calculated that Russia needed no aid, and that their balance of payments gap was "essentially zero."[30] Furthermore, half of IMF funds provided to Russia carried the stipulation that they be used solely for artificial currency support.[31] While this rationale was based on containing inflation, the Russian ruble was already overvalued. This instance of capital flight led to a flooding of imports, causing domestic production to lose a great deal of competitiveness on international markets, and was a drain on capital resources. Russian industry eroded, with their productive capacity declining by 40 percent over six years. Russia would not see its GDP fully recover to pre-1989 levels for almost a decade.

[29] Sachs, J. D. (1995, March 31). "Russia's Struggle with Stabilization: Conceptual Issues and Evidence" The World Bank. http://documents.worldbank.org/curated/en/201511468759016872/Russian-Federation-Russias-struggle-with-stabilization-conceptual-issues-and-evidence
[30] Sachs, J. D. What I did in Russia.
[31] Song, Keunwon. "Four Reformers in Russia's Shock Therapy"

Figure 3.2: Russia's Industrial Output, 1992-1998



32

Sachs made a specific enemy of IMF point man, John Odline-Smee, calling his advising "dangerously narrow and misconceived." Sachs called this lack of Western aid his "greatest frustration" during the time, arguing that

> "The IMF was simply parroting the political decisions… rather than making an independent assessment … the very low quality of IMF analysis and deliberations … seemed to be driving towards conclusions irrespective of the evidence. The IMF's approach was in any event just what the rich countries wanted to hear. The technical methodology was primitive beyond belief."[33]

Moreover, the IMF further encouraged Russia to take out foreign loans for deficit financing. With their debt already amassing $65.3 billion in 1991, over the next 6 years it great to over $110 billion, contributing the Russia's 1998 economic crisis.[34] The United States would not commit to large-scale financial aid. When Sachs pressed senior U.S. official Lawrence Eagleburger for assistance in garnering aid for Russia in 1992, he was met with a simple response; "It's an election year. There will be no large-scale financial support."[35] Sachs

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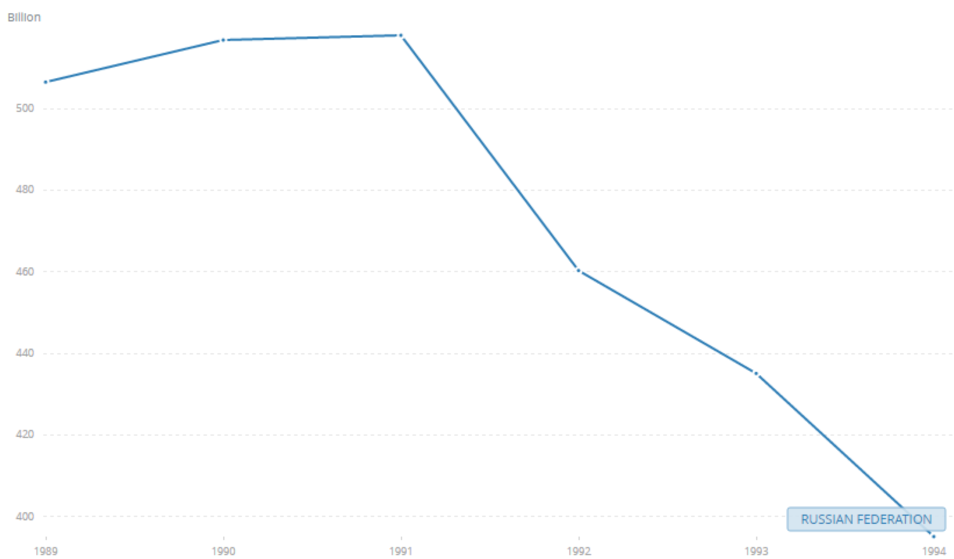
[32] Ibid. (Retrieved from BOFIT 2013L data from Rosstat, Central Bank of Russia)
[33] Sachs, J. D. What I did in Russia.
[34] Song, Keunwon. "Four Reformers in Russia's Shock Therapy"
[35] Sachs, J. D. What I did in Russia.

continued to work with other U.S. officials, such as U.S. Ambassador Robert Strauss, but was unable to mobilize any substantive assistance for Russia. By 2001, roughly 10 years after the start of reforms, the U.S. had only sent an estimated $1 billion in aid, much of which was earmarked in the same way that IMF funds were. Then again, from the U.S. perspective, there was understandably no solid interest to help revive what was an "arch-nemesis."[36]

This however, was only one part of Russia's, and by extension Jeffrey Sachs's problem. Later in 1992 Viktor Gerashchenko was appointed the new Chairman of the Russian Central Bank. The former Chairman under the Soviet Union, his return was mandated by the anti-reformist majority of the Supreme Soviet - which controlled his appointment under constitutional authority. Sachs "doubted Gerashchenko's ability to manage the Bank from the very first meeting [he] had with him," and at the time Sachs famously called Gerashchenko the "worst central banker in the world."[37] Sachs condemned Gerashchenko's backwards economic policy, which called for the increase of the money supply by around 30 percent per month in a misguided attempt to help domestic industries compete internationally.[38] Ignoring Sachs's arguments to the contrary, Gerashchenko maintained that increasing the money supply would increase the output of supply, putting more good on the markets, and reducing prices.

[36] Song, Keunwon. "Four Reformers in Russia's Shock Therapy"
[37] Mellow, Craig & Caplen, Brian & Katz, Rachel. (1995, September) "Russia Comes in from the Cold," *Euromoney*, No. 317.
[38] Sachs, J. D. What I did in Russia.

Figure 3.3: Russian Federation GDP: 1989-1994



39

As Sachs correctly predicted, high inflation resulted that ultimately ran close to the brink of hyperinflation. In 1992, Russia's GDP fell by 14.5%.[40] In that same year, inflation rose to 2,500 percent.[41] To make matters worse, Gerashchenko authorized the Central Bank to issue enormous credits at subsidized rates of 10 or 25 percent per year. These discounted credits were in reality tantamount to subsidies, and completely discredited market reform efforts. In 1992 alone the net credit issue of the Central Bank of Russia was "no less than 31.6 percent of GDP."[42] By early 1993, Russian economic strategists were calling for a change in leadership at the Bank, claiming that Gerashchenko's policies were sabotaging negotiations with the IMF and that the bank was refusing to carry out the government's financial reforms, or even provide data

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[39] World Bank Data, GDP (Current $USD) http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=1994&locations=RU

[40] World Bank Data, GDP (Current $USD)

[41] Aslund, Anders. (1999, April) "Why Has Russia's Economic Transformation Been So Arduous?" World Bank. p 9.

[42] Ibid. p 9.

on the credit it was funneling to inefficient Soviet-era industries.[43] At a certain point, due to how incredulously backwards Gerashchenko's policies were, Sachs speculated that his policies were either "the result of massive corruption, macroeconomic ignorance, or a combination of the two."[44]

Closed out of the Central Bank and cut off from any substantive assistance by the IMF, Jeffrey Sachs was losing allies quickly within his first year officially advising Russia. To make matters worse, Sachs had not met with Yeltsin in person at all in 1992, only in their meetings before the dissolution of the Soviet Union. While Gaidar had been elected Prime Minister in June of 1992, the Congress of the People's Deputies, due to anti-Yeltsin sentiment and upheaval over the country's economic dismay, refused to confirm him. As a result of this, Gaidar lost his position in December 1992, and was replaced with Viktor Chernomyrdin. With allies gone, and hope waning, Sachs claims to have planned to leave his role as adviser within the same month.[45] However, while on Christmas vacation, Boris Federov contacted Sachs. Describing him as a "very tough-minded reformer from Yavlinsky days," Sachs was informed over the phone that Federov had been appointed as the Finance Minister in the Chernomyrdin Government, and wanted Sachs's support.

Sachs agreed to meet with Federov in Washington in early January 1993. Federov expressed fervent intention to fight the Russian Central Bank, and to introduce much more rational macroeconomic policies, asking for Sachs's guidance as an economic adviser. Sachs agreed, and was appointed a co-director, along-side friend and colleague Anders Aslund, of the

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[43] Gransden, Gregory. (1993, March 23) "Russian Economic Strategist Urges Replacement of Central Bank Head" United Press International.
[44] Sachs, J. D. What I did in Russia.
[45] Sachs, J. D. What I did in Russia.

Macroeconomics and Finance Unit (MFU). Furthermore, with the incoming Clinton Administration, Sachs felt hopeful that Western engagement and assistance could come to fruition. [46]

Unfortunately for Sachs, 1993 would be an even less successful year. The Clinton administration's focus on Russia was nonexistent as far as Sachs was concerned. Sachs even went so far as to claim that key foreign policy campaign adviser Michael Mandelbaum refused to join the Clinton Administration, because he came to realize that President Clinton would not support any such effort for major Western assistance to Russia.[47] Beyond the United States, Sachs failed yet again to persuade the IMF or the World Bank to help. While the MFU successfully wrote detailed and competent analyses of Russian inflation, as well as monetary and budget policy, these, according to Sachs, came to no avail. Federov's power and influence in the Chernomyrdin administration proved to be weak and unsubstantial. Federov spoke rarely to Yeltsin, who became even further removed from economic policy, and Sachs went another year without speaking with him directly.[48]

In October 1993, the Duma leaders led an attempted putsch against President Yeltsin, and Russia fell into Constitutional crisis. With Yeltsin's policies appearing to worsen Russia's economy, devastate its industry, and promote corruption, congressional mutiny ensued. Aleksandr Rutskoy, Yeltsin's own Vice President, denounced his government's program as "economic genocide."[49] This turmoil quickly turned violent, and the ten day conflict became the deadliest single event of street fighting in Moscow's history since the Russian Revolution, with

[46] Ibid.
[47] Ibid.
[48] Ibid.
[49] Bohlen, Celestine (February 9, 1992). "Yeltsin Deputy Calls Reforms 'Economic Genocide". *The New York Times.*

over 187 people killed and 437 wounded, with non-governmental sources providing estimates as high as 2,000.[50] With so many of his policies ignored, and no real allies left, Sachs finally resigned officially from his advisory role, alongside fellow Harvard economist Anders Aslund. Officially announced in January 1994, after the December elections, it was clear that there was no place for Western economists in Chernomyrdin's government. Disgraced after his successes in Poland and Bolivia, what Sachs learned from these previous triumphs simply wasn't enough to help him in Russia.

Truthfully, Chernomyrdin had never fully utilized the services of his foreign economic advisors, and yet he blamed their methods for Russia's hardships. Arguing that "Western economic methods… ha[d] done more harm than good" Chernomyrdin's government pushed to rely on more gradualist solutions, even though critics like Fyodorov rightfully contended that that they had never been able to apply any sort of "real" shock therapy since 1992.[51] In any case, while Sachs was no longer an economic advisor to the government of Russia, this did not mean his involvement in Russia's economic transition was over.

While clearly discouraged with the state of affairs in Russia, namely the corruption, lack of foreign assistance, and ignoring of his policy suggestions, Sachs still managed to work towards solutions through new means. After his resignation, Sachs worked with non-governmental organizations, conducting research and collecting data to support policy alternatives. First, by acting as the chairman of the Board for the Institute for Economic Analysis in Moscow for the year following his resignation, and then in mid-1995 by becoming the director

[50] Braithwaite, Rodric (2011). Afgantsy: The Russians in Afghanistan 1979–89. Profile Books. p. 312.
[51] Erlanger, Seven. (1994, January 22) "2 Western Economists Quit Russia Posts" *New York Times*

of the Harvard Institute for International Development (HIID).[52] As director of the HIID, Sachs oversaw roughly 60 projects in a plethora of different countries, but most notable was Andrei Shleifer's privatization efforts in Russia.

The Problem of Privatization

When initially meeting with Anatoly Chubais in late 1991, Sachs had attempted to steer policy towards careful and conditional means for divorcing the government from business. With Poland's privatization efforts now underway, it's clear Sachs's policy suggestions, and outright prioritization of the issue, were responsive with respect to Poland's struggle to restructure their large state enterprises. More interesting however, is how gradualist Sachs recommendations appear. Sachs saw "no urgency" in the privatizing of natural resource sectors, as he saw these as core earnings for the Russian government. Elsewhere he suggested mixed approaches wherein small shops would be privatized through auctions, and small and medium enterprises would have quick sales or leases to workers.[53] Sachs's main concern, however, was the privatization or the large state banks.[54] Without sensible incentives to restrict new lending, Sachs felt that the state banks would undermine economic efforts to allow for market self-regulation in favor of following government policy, as had occurred under Gerashchenko. Commercial banks, as Sachs argued, played a vital role in the governance of industrial enterprises both as creditors and equity holders, and when banks themselves are simply "bureaucratic organs of the state," they lack any incentive to carry out these functions. Sachs even admitted that this was the current problem

[52] Sachs, J. D. What I did in Russia.
[53] Ibid.
[54] Sachs, J.D. (1992, May). "Privatization in Russia: Some Lessons from Eastern Europe" *The American Economic Review.* Vol. 82 No. 2 p 43-48

taking place in Poland's privatization efforts, and as such it is clear that he was looking to avoid repeating mistakes.[55]

The problem for Jeffrey Sachs, however, as was the case with most of his advising in Russia, was that these recommendations would never amount to policy. In this case, Andrei Shleifer, while still Sachs's Harvard colleague, had radically different views on how to approach privatization, and was in charge of these reform efforts at the time. Ironically, Shleifer's approach seemed more in line with the radicalism that media normally attributed to Sachs. Shleifer, in the most basic sense, promoted the rapid and universal exclusion of the government from interfering with the economy. In Shleifer and his colleagues' book on the Russian privatization program, *Privatizing Russia,* the claim is made that "… in Russia, political influence over economic life was the fundamental cause of economic inefficiency, and the principal objective of reform was, therefore, to depoliticize economic life."[56]

The strategy behind Shleifer's economic program was to move radically and quickly in order to prevent any reversal in political power. With fears of reversion to a communist regime still present in the wake of the fall of the Soviet Union, on the surface Shleifer's approach wasn't entirely unsubstantiated, however Sachs later argued that this quick push of assets into private hands causes unfairness and corruption.[57] Unfortunately for Shleifer, the defensibility of these strategies end here as, in 1995, what would be dubbed the "loan-for-shares scheme" was implemented.

[55] Ibid. p 48.
[56] Boycko, M., Shleifer, A., & Vishny, R. W. (1995). *Privatizing Russia*. Cambridge, MA: MIT Press.
[57] Sachs, J. D. What I did in Russia.

In 1994, the Russian government deemed that too many enterprises were still state-owned. Shleifer's team had recently implemented a "voucher system" by which all Russian citizens were issued vouchers, with a nominal value of roughly $63 USD, to be used to purchase shares in selected state enterprises.[58] While this resulted in the privatization of over 70 percent of the economy – measured as a share of GDP or employment- this still was not the total divorce of the government and the economy that neoliberals championed – and Sachs had long ago compromised.[59] Furthermore, this also created a market for citizens to sell their vouchers for liquid cash at pennies to the dollar, thus providing one source of the oligarchic wealth accruing large holdings in whole industrial and commercial sectors.[60] Thus, a new solution was required that could still be compatible with the voucher system.

As it stood, stock prices were very small in relation to asset values, and any attempts at selling large portions of additional stocks would simply drive down stock prices further. The solution that Shleifer's team engineered, was to offer large blocks of state shares as collateral against bank loans through open auctions. This strategy would effectively keep stock prices stable and offering prices would just be current market prices.[61] The reason this later became known as a scheme, however, was that the plan ultimately went through with closed auctions. As a result, several notable bankers were able to secure large control of natural resource companies. Sachs later called the deal "a massive and corrupt transfer of natural resource enterprises to the Government's cronies, disguised as a collateralized loan to the Russian Government by Russian

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[58] Russia Voucher Privatization: 15 Years On. (2007, July 20). *RT*. https://www.rt.com/news/russian-voucher-privatisation-15-years-on/

[59] Aslund, Anders. (1999, April) "Why Has Russia's Economic Transformation Been So Arduous?" World Bank. p 17.

[60] Russia Voucher Privatization: 15 Years On. *RT*.

[61] Aslund, Anders. (1999, April) "Why Has Russia's Economic Transformation Been So Arduous?" p 19.

banks."[62] Claiming that these arrangements were blatantly corrupt from the start, Sachs remembered spending his final visit in Moscow in early 1995 as a whistleblower of sorts, attempting to warn Western officials of these perverse actions. But as was typical of Sachs's involvement in Russia, he was largely ignored.[63] Sachs later wrote and spoke extensively on Russia's growing corruption and even argued that it was possible that these massive "giveaways" of the oil and gas sectors were linked to campaign financing for President Yeltsin's re-election.[64]

Corruption however, did not contain itself within the Russian elite. On April 17th 1995, Jeffrey Sachs was faxed a letter from AID stating that a senior official in Moscow had a close relationship with the manager of a Russian mutual fund company, and "may have used his or her position to seek preferential treatment for this mutual fund and the fund's specialized depository." [65] As would later come to light, Andrei Shleifer was exposed for secretly investing in Russian securities, both by himself and through his wife's name, while leading the privatization project. Up until the time that Sachs had been informed, he was none the wiser. Colleagues and friends initially, Sachs had introduced Shleifer around the Russian government at the beginning of their involvement, even being the one to decide that Shleifer would work with Chubais on privatization while Sachs himself advised Gaidar; a decision he'd obviously come to regret.[66] As the director of the HIID at the time of the scandal, Sachs was one of the first to become aware of the internal investigation that was surrounding Shleifer. As Sachs recalled, Shleifer attempted to portray the investigation as a "vendetta" orchestrated by "enemies" of

[62] Sachs, J. D. What I did in Russia.
[63] Ibid.
[64] Sachs, J.D., & Pistor, K. (1997). *The Rule of Law and Economic Reform in Russia*. Boulder, CO: WestviewPress.
[65] McClintick, D. (2006, January 13). How Harvard Lost Russia. *Institutional Investor*. Retrieved from http://www.institutionalinvestor.com/article.aspx?articleID=1025823&single=true#.WLVmvfkrKUk
[66] Ibid.

Harvard, who he claimed to be competing universities that had bid for the Russia job and lost.[67] Ironically enough, it was Sachs years earlier who had warned Shleifer of the corruption present in Russia.

Sachs immediately moved to remove Shleifer from the project once proof his conflict-of-interest surfaced. Harvard and Shleifer were ultimately prosecuted by the U.S. government, with Harvard ordered to pay $26.5 million in fines, and Shleifer $2 million.[68] But as with most cases of corruption in Russia, Shleifer's punishment was minimal; his net worth exceeded $40 million, and he remained a faculty member of Harvard in good standing.[69] This fraud ultimately made the U.S. government more reluctant to listen to external advisers, and more skeptical about assistance. But perhaps even more damaging, it gave merit to the Chernomyrdin government's resistance against the advising of western economists, tarnishing all Western-led reform efforts.[70]While Sachs, as the acting director of the HIID, was ultimately found to have had no knowledge of any of Shleifer's inappropriate behavior according to the USAID's official investigation, questions do arise as to the level of Sachs's attentiveness to allow such criminal acts to go unnoticed under his supervision, as well as his judgement in allowing such an individual to commit these crimes.

Ultimately, Sachs's own advising on policies went unheeded, and the implementation of Shock Therapy in Russia arguably never fairly occurred. Completely different from his experiences in Bolivia and Poland, Russia called into question the merits of shock therapy as a practice. However, as this chapter has argued, the unresponsive and corrupt political culture

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[67] Ibid.
[68] Song, Keunwon. "Four Reformers in Russia's Shock Therapy"
[69] McClintick, D. How Harvard Lost Russia. *Institutional Investor*.
[70] Song, Keunwon. "Four Reformers in Russia's Shock Therapy"

surrounding Russia at the time caused major pushback to all reform efforts Sachs attempted to propose. As Balcerowicz remembered,

> In Russia, for political reasons, reformers were not given the same amount of chance. So after only half a year, there were disruptions in the economic program, especially on the fiscal side and on the monetary side. So the stabilization effort was not given a chance, and this is the main reason why Russia is less successful than Poland. One has to look for political underpinnings of economic policy and perhaps the role of personalities, because economically speaking, Russia's starting conditions were not very difficult. There were possibilities for improvement.[71]

Sachs called for large-scale financial assistance for Russia, in order to fight hyperinflation, but it never came. Sachs urged Russia to adopt a strong monetary policy to end the rapid inflation, but instead the opposite was implemented. Sachs counselled Russian officials to undertake a transparent and law-based privatization plan, but instead his own colleague saw fit to encourage and partake in corruption. Whether Sachs's plans would have succeeded is up to speculation, but it is clear that a complex Soviet economic inheritance greatly complicated his efforts.

[71] Leszek Balcerowicz. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. November 12, 2000.

Conclusion

As then Bolivian Minister of Planning, Gonzalo Sachez de Lozada later remembered,

> Jeff Sachs took the Bolivian experience and adapted it to the reality of Eastern Europe in Poland, and Poland has been a very successful transition. Then he took it to Russia. I don't say he took a lot more things to Russia, but he took the experience of Bolivia, and there he failed because there wasn't a political will. Everybody has to remember that economics is very tied to politics. Bad economics lead to social problems that lead to political problems, and usually you can't solve economic problems until you have political solutions, and Poland had it; Russia didn't; we did.[1]

Highly scrutinized and bringing about in mixed outcomes, shock therapy's practical application in Eastern Europe proved to be as contentious as it was unique. While Jeffrey Sachs himself was not a lone actor, working with other foreign economic advisers and local members of government, the power bequeathed upon this young economist, and the influence his theories had, undoubtedly shaped the course of the nations he advised for decades. This case study of western economic intervention in market construction has provided several important characteristics inherent in understanding the practical limits of marketization, the reality of market transition, and the costs and benefits of rapid market liberalization.

In Bolivia, both Jeffrey Sachs, as a young unexperienced economist, and his new concept of shock therapy, a relatively unprecedented and untested economic theory, found support and success in quelling hyperinflation. Much of this success, as compared to Eastern Europe, came from the relative simplicity of Sachs's role as an economic advisor in Bolivia. With a short-term assignment to help quell hyperinflation, and not acting as a long-term development advisor, Sachs was able to implement shock therapy on a desperate country, without the international

[1] Sanchez de Lozada, Gonzalo. "Up for Debate: Shock Therapy: Bolivia, Poland, Russia. Same Policies-Different Results." Interview. Commanding Heights. March 20, 2001.

pushback that plagues his later work in marketization of the former Soviet Empire. That said, Bolivia still required a suspension of constitutional rule, a military state of siege, widespread strikes, and the internment of political opponents, especially labor leaders to be implemented; a portion of the transition that Sachs himself is reluctant to draw attention to.

While the level of Sachs's practical impact in Poland and Russia can be debated, in Bolivia it is clear that he had immense reach in his advisory power, and that shock therapy, while still in its infancy, was adhered to fully. As Bolivia's then Minister of Planning later remembered, "It was a Herculean effort that got it (Bolivia's economic recovery) going, and we brought in people like Jeff [Sachs] and others. Many others joined him, but basically Jeff was a prime mover in how to make this stability stick, how to achieve growth."[2] An overall success, debt forgiveness and cancellation played a central role in giving Bolivia the ability to recover. As was the case with all the countries explored in this thesis, the provision of foreign subsidies via debt forgiveness and other strategies proved to be one of the largest determinants of shock therapy's success. As such, Sachs's ability to bargain with the IMF, while inconsistent, was critical to the nations he advised.

While Bolivia's economic recovery was undoubtedly successful, the drawbacks of shock therapy's rapidity manifested in the form of riots and protests. While Sachs himself downplays the intensity of the unrest in later recollections, objectively the use of military force and internment camps deprived workers of their rights and liberties, and forced Bolivia into a constitutional state of siege.[3] While Sachs's methods can be justified by the time sensitivity of

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[2] Sanchez de Lozada, Gonzalo. "Up for Debate: Shock Therapy"
[3] Zuazo, A. (1986, September 1). Bolivian President Seeks Support for State of Siege. United Press International. Retrieved from http://www.upi.com/Archives/1986/09/01/Bolivian-president-seeks-support-for-state-of-siege/9933525931200/?spt=su

Bolivia’s hyperinflation, this often-ignored short-term consequence proves at the very least that even if successful, shock therapy’s rapid transition does not come easily.

Regardless of his downplaying of Bolivia’s workers’ protests, it is obvious that Sachs was not advising in a vacuum, but learned from Bolivia’s hardships. When he began advising in Poland, it’s clear in the rhetoric of his speeches, and in his policy memos, that Sachs was forthright with the Polish people about the short-term consequences that shock therapy would have on their economy. While not necessarily expecting another instance of military intervention in rioting over oil prices, Sachs fundamentally admitted that with his economic practice came short term hardships, before the recovery. While shock therapy as a practice was welcomed, Sachs’s influence in Poland, as compared to in Bolivia, functioned differently.

Acting on a much larger stage with more international attention, Sachs’s role as a foreign economic adviser was inherently different than it was in Bolivia. Working with a team of Polish economists, and IMF representative David Lipton, Sachs’s was not the only opinion in the room; however, from his initial reform memo, co-authored by David Lipton, to the Balcerowicz Plan, the core ideas of shock therapy clearly made their way into Poland’s economic transformation to a market economy. Where Sachs played a key role then, may not necessarily have been in what he proposed, but rather in who he was. As Balcerowicz later recalled, “I think Jeff Sachs played a very important role in Poland in persuading those who needed persuasion. [Beforehand] Not everybody was persuaded that the best way was a radical transition to a free-market economy.”[4] As a Harvard economist giving speeches besides Robert Dole to the Polish parliament, Sachs’s intentional use of Solidarity’s “Return to Europe” slogan clearly reassured skeptics in Poland

[4] Leszek Balcerowicz. "Up for Debate: Shock Therapy”

about the risks and rewards of undergoing a radical transition. Arguably, Sachs acted more as a catalyst for support of radical economic ideas that were already present, than as their originator.

Where Poland deviated however, was in privatization. While the reasoning behind the avoidance of the issue of privatization early on in Sachs's involvement still remains unclear, the efforts that were ultimately enacted were much more gradualist than Sachs had advised. Sachs's failed attempt at implementing NIFs, and his overall lack of involvement in Poland's privatization efforts created complications for the country over the next few years of transition. Furthermore, while Poland ultimately succeeded greatly, they did so while deviating from Sachs's recommendations. As such, the success of shock therapy in Poland is mitigated by the simple fact that much of their long-term success came from more gradualist policies than those Sachs advised.

While Poland disagreed with Sachs on particular issues late in their transition, Russia completely ignored him. Sachs played a minimal role in Russia compared to his previous work in Poland and Bolivia, and while some of his initial suggestions were carried out, with a significant lack of international support, an uncooperative Central Bank, and unfettered corruption, it's clear that shock therapy was not implemented fully or correctly. Moreover, Sachs himself was no longer the main architect of reform, but instead part a team of foreign advisers in Russia,

Why did Sachs's time as an adviser in Russia result in failure? It's clear that he came with lessons from Bolivia and especially Poland. Sachs was incredibly successful in previous interactions with the IMF in achieving debt forgiveness and/or cancellation, and as such, led an effort to establish negotiations with them concerning Russia. As a respected Western economist, Sachs's ability to invoke support from the United States among other western countries, and the IMF itself, was a unique feat that Poland and Bolivia were unable to successfully accomplish before his intervention. Unfortunately for Sachs, the geopolitical atmosphere surrounding the new Russian federation compromised his efforts there entirely. The United States, as was much of the West, was not interested in reviving an “arch-nemesis” and with little foreign aid, Russia was forced to continue to pay off debts while faultily proceeding with marketization efforts.[5]

Ultimately this examination of the practice of shock therapy, through its leading architect Jeffrey Sachs, sheds light onto the process and hardships that befell the nations that chose to adopt it in the late 1980s to early 1990s.Overall, Sachs’s policies were not stagnant and unchanging, but attempted to respond to the individual needs of each country that he advised. That said, as a foreign advisor, Sachs at times was not prepared for the cultural and political environments he was stepping into, and thus, procured mixed results. Shock therapy as an economic practice very clearly relies on several contextual factors domestically, but also internationally, to be successful; namely on a healthy international political climate that is cooperative and willing to support debt forgiveness. As a short-term solution for hyperinflation, shock therapy proved to be effective in each country, albeit in some cases tumultuous. As the foundation for a long term economic effort, however, the impacts of such rapid reform clearly leave pause for concern. While the complications of macroeconomic stabilization tended to obviously be mired by contextual hindrances, it’s clear that Jeffrey Sachs’s implementation of shock therapy was most successful when supported by the international community. In conclusion, this case study of shock therapy serves as an important examination of the evolution of ideas behind, and inherent struggles of, transition economies undergoing market liberalization.

[5] Song, Keunwon. "Four Reformers in Russia's Shock Therapy: Insufficient and Incompetent External Help & the Lack of Internal Political Consensus and Control." Vestnik: The Journal of Russian and Asian Studies, April 4, 2016. http://www.sras.org/shock_therepy_russia_fail.

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