Volume Title: Money, Financial Flows, and Credit in the Soviet Union

Volume Author/Editor: George Garvy

Volume Publisher: NBER

Volume ISBN: 0-884-10475-3

Volume URL: http://www.nber.org/books/garv77-1

Publication Date: 1977

Chapter Title: The Reform Ten Years Later

Chapter Author: George Garvy

Chapter URL: http://www.nber.org/chapters/c4161

Chapter pages in book: (p. 183 - 189)

9

The Reform Ten Years Later

ALMOST ten years after it was initiated, evidence as to the contribution the Reform has made so far to increasing the efficiency of the Soviet economy and the rate of growth of GNP is still inconclusive; this is particularly true of the financial aspects of the Reform, which alone concern us here. In assessing the economic growth of the Soviet economy since 1965 in its various significant aspects (such as the relatively more rapid improvement in consumer well-being), it is well-nigh impossible to disentangle the influence of measures considered part of the Reform from those that are, in essence, the continuation of policies initiated several years earlier, many of which are associated with the name of Khrushchev. These include the monetization of *kolkhoz* operations, greater emphasis on progressive technology, a minimum income for farmers and higher minimum wages for workers, greater emphasis on housing and managerial training, and greater mobility of the labor force.

The direct effects of the Reform on labor productivity, unit costs, profitability, and the distribution of the social product are obscured by changes in the computation and presentation of official basic data, and by lack of information as to which of the new rules and policies are actually being implemented. There is evidence that outward compliance has not been accompanied by significant changes in old ways, and that postponement or suspension of the new system has resulted in considerable differences among industries. In many cases, the general principles of the Reform have been modified and adapted to the conditions and requirements of individual industries, product lines, and economic administrations and regions.

By the time the twenty-fourth Communist Party Congress was held in March 1971, the term "economic reform" had nearly vanished from the scene.[1] Subsequently, certain measures were taken that actually represent a back-sliding from the Reform: additional targets ("directive indicators") were reintroduced (such as labor productivity targets at the enterprise level and experimental targets for wage cost per unit of output, authorized by individual ministries and republic authorities), and the progressivity of payment schedules for bonuses was reduced. Some important measures, initially announced as an integral part of the Reform, were never put into effect, while others were introduced only partially. Alongside all this, however, some measures are being passed from time to time that are designed to implement various aspects of the original reforms. Instead of simplifying the workings of the economy, the Reform, by superimposing new rules on a system that retained its basic structure, merely added to its complexity. Fear of the consequences of departures from familiar routine and uncertainty about the effects of the new arrangements on output, productivity, availability of inputs, and disposal of outputs—as well as concern about their authority and relationship with supervisory bodies—caused many enterprise directors to take a wait-and-see attitude and to actually resist change, covertly and even openly.

It is abundantly clear that resistance and downright sabotage by bureaucrats, believing themselves threatened by the changes and the complexity of the changes introduced in the financial mechanism, has caused considerable confusion. By and large, these changes were inadequately prepared for. Where room was left for interpretation and adaptation, the Reform resulted in a variety of combinations of the old and the new. Additional rules, norms, and techniques were frequently added to, rather than substituted for, what existed before. Ever since the inception of the Reform, the best ways of introducing the new financial techniques and of adapting them to specific conditions in individual industries have

[1]See Grossman in Dodge [112] and [238] and Schroeder [249] and [251]. See also J.E.C. [154], Prybylola [246].

been the subject of discussion in meetings, conferences, newspapers, and journals.

The fact that money flows, credit, and interest rates now play a more important role than before the Reform in oiling the wheels of the economic machine to increase its efficiency does not in itself represent a significant change. Nor does the new emphasis on financial incentives necessarily reduce interference from the central authorities. "Financial levers" can be manipulated no less than "norms" or other physical ratios, constraints, and targets—with the same potential for misallocating resources and offering inadequate incentives.

Greater availability of retained funds and bank credit is an essential condition of, but no guarantee for, decentralizing investment decisions. The main problem of socialist economies is not to raise enough investment financing but to optimize its use. So far there is no evidence that enterprises have been able to exert greater influence on the patterns of investment and to reduce the time lag between the inception and the completion of a project.

The Reform has failed in its central objective—to provide financial incentives powerful enough to maximize enterprise efforts to introduce advanced technology. This is important, for it has been identified by proponents of the Reform[2] as essential for improving the performance of the Soviet economy, together with decentralization of research and development and heightened interest by ministries and other supervisory authorities in the introduction of new technological processes and more advanced machinery.

Failure to come to grips with the central problem of the role of prices as a resource allocator has limited the significance of the various changes introduced under the Reform. The postulate of marginal pricing and clearing the market may not be adequate for steering the economy in a direction that would conform with the intentions of the responsible political authorities. However, while producers need not be guided by prices alone, planners

[2]See, for instance, V. Trapeznikov's important article in *Pravda* in August 1964 and his critical comments on the failings of the Reform in *Sotsialisticheskaya Promychlenost'* (Socialist Industry), December 3, 1970.

On the introduction in July 1971 of specific sales targets for technologically advanced items in individual enterprises see earlier discussion.

must be ready to accept existing price relationships as sufficiently realistic to provide a basis for rational decisions. Adjustments in the price structure stemming from the Reform have attempted to make demand enter the process of price formation, but have nevertheless been made bureaucratically.

There is little evidence to suggest that the new "financial levers" operate as market allocators rather than merely as substitutes for orders from the planning center. An interest-free loan (or loan proffered at a preferential rate) may be a sugar-coated order; can the director afford not to take it without having to face up to "public criticism"? A considerable number of arrangements under the new system provide opportunities for continuing administrative interference, such as setting differentiated capital charge and depreciation rates. Actual experience so far suggests that survival of administrative controls has interferred with the play of "financial levers," which in many cases operate merely as auxiliary mechanisms of the command economy.[3]

The use of some indicator of profitability as a guide for structuring output and making investment decisions is important, whether such decisions are made by the central authorities or by the enterprise. But a significant improvement in enterprise efficiency is likely to require greater enterprise autonomy in the disposition of profits than has been in evidence. Only to the extent that the profit level significantly and directly benefits them will the individual enterprise and its staff have sufficient incentive to maximize profits as contrasted with meeting profit targets.

There is little evidence that this has been a significant result of the modest restructuring of financial flows. The enterprise director is still far from being a quasi entrepreneur, although he has somewhat more latitude than before in planning as well as in day-by-day operations. By restructuring production in favor of sellable items with the largest profit margin, he can attempt to increase profits beyond what they would be solely on the basis of productivity gains and enlarged volume, provided he is not exceeding the limits imposed from the outside. He is not free to set prices for his output, or to choose among substitutable inputs. The much-

[3] It is significant that in explaining the benefits of the new system, authorities emphasize that it will help to "disclose" hidden reserves, which apparently escape detection through the existent systems of financial and other controls.

emphasized contractual relationships he is free to establish with his suppliers are, in fact, limited to a spelling-out of such details as delivery dates, since sources of supply, quantities, and general specifications of inputs are determined by outside agencies. Few of the intended changes in supply arrangements for raw materials, intermediate products, and capital goods, designed to introduce some degree of flexibility, have been implemented.

Administrative economic agencies (such as *glavks*) are still not operated on a business accounting basis. In spite of the emphasis on the managerial aspects of the Reform, most of the main problems of optimal industrial organization remain unresolved. The most important single change since the Reform was the creation of large horizontal or vertical groupings of enterprises *(ob'edineniye)*. It is uncertain whether such larger groupings (an organizational form that has become important in several of the smaller socialist countries) retaining the enterprise as the basic operating unit will be more than administrative substitutes for the present subdivisions of industrial ministries. Only modest progress toward the creation of such larger operating units has been made so far.

The emphasis on money and the role of credit in achieving a less wasteful use of resources on the microeconomic level must be viewed in the light of past failures to achieve satisfactory results in this area. As long as interest rates remain rigid and unresponsive to either demand or supply, their role in achieving an optimal allocation of resources is likely to remain essentially that of another administratively determined variable.

Is something identifiable as a "socialist monetary policy," rather than merely an improved use of credit and rechanneling of financial flows, about to emerge as a result of the Reform? Even though an answer still cannot be hazarded, it appears that the new developments are more likely to enhance the role of the State Bank as a financial intermediary than to endow it with the attributes of a central bank in the Western sense, or give it a greater role in managing aggregate demand. At best they will make access to credit increasingly dependent on the individual enterprise's profitability, its balance sheet, and, indirectly at least, the quality of its management. But even if the monobanker is ultimately permitted considerably more flexibility than in the initial stage of the Reform in dealing with microeconomic problems, thereby becoming a more efficient commercial and investment banker, this would not necessarily entail a basic change in the role of banking and the credit system.

So far the "new system of economic steering" has gone little beyond giving formal recognition to money as an agent of economic activity. It has not assigned to money any precise new functions. Hardly anything has been done beyond legitimatizing the role of money as a result of a tedious discussion on the "goods-money relationship." The role assigned to money may change if the relative weights attached to the plan and to the market in the new scheme of things shift in favor of the second, even if market processes and feedbacks are still limited to the consumption sector.

Is there room in the reformed economy for a specific socialist monetary and financial policy, as distinguished from monetary planning? What is the precise role of money in the new system of economic guidance? To what extent are money flows to guide rather than merely to reflect real flows? And how is the shift from the control function to an allocative and incentive function to be accomplished? Will the role of money be enlarged from microfinancial controls to a macroeconomic tool?

In order to acquire a market function, money must become a true "bearer of options" in the production as well as in the household sector. The transformation of passive into active money hinges on a number of factors. A price system balancing demand and supply and reflecting relative scarcities and substitution options is the *sine qua non* of such a system; without it, maximization of profits cannot serve as a guide to enterprise behavior, and domestic prices cannot guide foreign trade. Money must acquire a bigger role in emitting directional signals to production. This requires a unification of money in domestic uses.

To sum up: ten years after it was launched, it still is uncertain to what extent Reform has improved the functioning and effectiveness of the Soviet economy. The problem of optimizing the use of resources, tackled even before the Reform by Soviet policy makers from various angles (for the economy as a whole, for individual branches like power and transportation, and for individual industries like coal), remains unsolved. The contribution of the

Reform to this problem has been minor, since one of its primary objectives is increasing the efficiency of existing investment rather than optimization of new investment.

Because of its limited scope (compared, for example, to the 1968 measures in Hungary), the immediate impact of the Reform was modest as is evident from comparisons made in the transitional years between enterprises that shifted to the new system and those that continued under the old rules. The same conclusion emerges when considering the overall achievements of the eighth Five-Year Plan (1966–1970) and of the ninth Plan, which is drawing to its end, although bad weather and the resultant decline in agricultural production, still basic to the Soviet economy, were significant contributing factors.

It would lead us beyond the scope of this study to probe into the reasons why the Soviet Reform was begun so half-heartedly by cautious politicians and was later almost stopped in its tracks by bureaucrats who felt threatened by the changes. The reasons are complex and—like everything else in the Soviet Union—by no means related primarily to economic considerations.