Soviet Bureaucracy and Economic Reform

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Evolution in Perestroika Thinking

Gorbachev announced his intent in 1985 to introduce radical economic reform to the Soviet Union. He deliberately used the term "radical" to differentiate this reform from the half-hearted reforms of the past. The perestroika process has been running for over five years and has yielded few positive results.

The reform thinking of the Soviet leadership has evolved through three phases, although, it must be noted, the third phase is still in its infancy. Moreover, no one knows whether the Soviet Union will ever embark seriously on this third stage.

The first phase of perestroika dates to its first three to four years. This phase was characterized by naive expectations. It was thought that with relatively minor tinkering, the Soviet planned economy could be revived. A simple reduction in bureaucratic meddling plus the massive Western assistance that would be attracted by political liberalization would allow the Soviet economy to accelerate (uskorenie).

The second phase began in the 1988-1989 period, when it was clearly realized that minor tinkering would not yield the desired results. At this point, the leadership concluded that reform must go beyond minor repairs and deal with substantive issues. During this phase, it was determined to weaken the bureaucracy's hold on the economy and to unleash more local initiative. Although it was realized
that fundamental legal, economic, and social reforms in laws and property rights were required, the argument was that these would take time, and that one must proceed with caution on introducing fundamental reform. However, it was felt that positive results would be achieved as a consequence of reducing the interventionary powers of the bureaucracy. During this phase, particular attention was devoted to the perceived problems of macroeconomic stability. Fundamental reforms could not be introduced prior to the introduction of stabilizing measures.

The third phase, which remained in its infancy in early 1991, began with the realization that reform requires dealing with the fundamental long-range issues. Institutions must be created that support market-like resource allocation. Property rights, freedom of and protection of contracts, and modern banking based upon commercial principles must be introduced. Although these issues have yet to be addressed concretely by official reform proposals, they are prominent in the reform packages put forward by the Yeltsin group—the 500-Day Program.

**Issues of Bureaucratic Opposition**

What exactly does the Soviet economic bureaucracy want from the reform process? What is the reform program of the bureaucracy? To a great extent, whether recognized or not, the interests of the bureaucracy have been reflected in the reform program of the Ryzhkov and Pavlov governments. The bureaucratic attitude towards reform can be characterized by the following propositions.

1. The economy is not yet ready for markets for a variety of reasons, the most prominent being macroeconomic imbalances.
2. Reform is inevitably a slow process in which substantive reforms must be introduced gradually.
3. The costs of rapid reform are too substantial. Reform must be introduced gradually to limit the social costs.

Why do bureaucrats oppose substantive economic reform? A number of reasons can be suggested, both valid and invalid.
First, they realize that true economic reform means a loss of jobs and a reduction in authority and prestige. The reform discussion has already made them pariahs in their communities.

Second, economic reform is truly a power struggle, a struggle over who controls economic resources: Who will control diamonds, or oil, or building permits? These decisions determine who has the power in society.

Third, among the bureaucracy there is a sincere feeling that the economy will collapse without centralized directives. Planners and bureaucrats have an ingrained physical balance mentality that causes them to fear market allocation. They simply cannot perceive how it could work. To Soviet bureaucrats, “deficits” are inherent to the economy. They can only be removed by administrative measures, not by prices.

Although it is generally perceived that Soviet managers form the natural constituency for radical reform, this is far from the case. There is a true ambiguity of managerial attitudes towards reform. Experienced managers have developed a comfort level with the old system. They understand that the transition period will be rocky. Moreover, the outcome of reform is by no means certain. Managers understand that a half-way reform would likely leave them worse off. Attitudes towards reform vary depending upon whether managers will have ready markets for their goods both at home and in the West after the marketization has taken place. It is noteworthy that the major organized opposition to reform from the ranks of managers has come from directors of heavy-industrial establishments.

Bureaucratic Excuses

Bureaucrats put forward a number of reasons for delaying substantive reforms and continuing to rely on minor tinkering.

First, bureaucrats cite the specter of inflation. Because Soviet prices have for decades been kept at artificially low levels, especially retail
prices, conversion to market resource allocation would mean substantial increases in prices.

It is interesting to note the emphasis placed on fear of inflation in the Soviet Union. Lenin had described inflation as the instrument that can destroy capitalism, and this thinking has caused Soviet authorities to have a perhaps irrational fear of inflation, which is shared by the population. Soviet bureaucrats and authorities confuse the income redistribution effects of inflation with the inefficiency effects of inflation. It is clear that a move to clearing prices will have strong income redistributing effects, and that measures to protect those on fixed incomes must be put in place. The move to clearing prices, as long as it does not lead to hyperinflation, however, should have a positive effect on efficiency. People and managers will, for the first time, make resource allocation decisions based on relative scarcities. Economic theory has taught that moderate inflation, if properly anticipated, does not affect real output and hence efficiency.

Second, Soviet bureaucrats use the specter of monopoly as an excuse for not moving into the third phase of reform. The administrative-command economy has, over the years, created a highly concentrated industrial structure with individual suppliers having significant market power. Bureaucrats argue that one cannot use market allocation with such high levels of concentration. Planners must use their control of investment decisions to create a system of alternate suppliers before moving to market allocation.

The process of creating alternate suppliers will be, at best, slow and gradual. Moreover, it seems unrealistic to rely on the planning structure—which created the monopoly problem in the first place—to create an optimal industrial structure. Bureaucrats do not understand the notion that free entry under conditions of market allocation is a more reliable way to resolve the monopoly problem even though they recognize that state pricing rules can be used to limit monopoly profits during the transition period.

Third, Soviet bureaucrats contend that opening the Soviet economy will have disastrous consequences unless foreign transactions remain under the center's strict control. Such concerns are not unusual in a
country with limited foreign exchange earnings and growing hard currency debt. Other bureaucratic concerns about opening the economy are less standard. Soviet foreign trade bureaucrats believe that only "rich" economies can gain from trade. If the Soviet economy enters the international trade arena as a "poor" economy, it will prove uncompetitive. This type of thinking ignores the fact that comparative advantage allows both rich and poor countries to benefit from trade, if they specialize according to comparative advantage. The corollary of this thinking is the belief that the Soviet economy must first become "wealthy" before it can effectively trade with the West. Insofar as this "wealth" is a long way off, liberalizing foreign trade must be delayed.

Another nonstandard reason for delaying trade liberalization is the fear that valuable Soviet resources will be lost. Given the distorted domestic pricing system, unscrupulous Westerners will take advantage of pricing "mistakes" in both Soviet products and assets. These pricing mistakes will allow the Western world to acquire Soviet products and assets at unreasonably low prices.

The fear of Western exploitation reflects bureaucratic attitudes towards pricing. The Soviet bureaucrat views prices as instruments to be controlled by higher authority; under this system, prices do not change frequently. Even if pricing officials see that particular Soviet products and assets are being bought by Westerners at alarming rates, they would not be able to use these pricing signals quickly enough to raise prices to prevent the exploitation from taking place. Rather than viewing Western purchases as a means of obtaining valuable information on scarcity prices, Soviet pricing officials view Western purchases as a destabilizing threat. Similar fears, for example, prompted high Soviet officials in early 1991 to warn of Western banking conspiracies aimed to buying valuable Soviet products and assets at bargain-basement prices.
There has been a substantial dismantling of the Soviet economic bureaucracy. Staff cuts in Moscow bureaucratic organizations have averaged 30 percent; the industrial ministries—organizations that provided the glue that held the command system together—have been hard hit. Industrial enterprises no longer answer to the local party secretary. It is unclear who can make and enforce decisions in today's Soviet economy. The balance of power has begun to shift towards the enterprise and away from the state committees, industrial ministries, and local party officials. Enterprises no longer automatically fulfill directives from above.

Restrictions of enterprise autonomy remain most prominent in those areas most essential to marketization of the Soviet economy. Enterprises still are not free to set their own prices, acquire their own supplies, and complete deals with Western companies. Pricing officials continue to insist on cost-based pricing formulae that do not reflect demand and that "protect" the public from excess profits. Industrial managers must sell deficit products at state-dictated prices that often provide little or no profit. Few Soviet bureaucrats want wholesale trade to replace centralized distribution, even though this is a declared goal of perestroika. In fact, most feel that wholesale trade would worsen rather than help the troubled material-technical supply system, which remains the weakest point in the Soviet system.

What reform package would Soviet economic bureaucrats be willing to support? They would like to see an economic system in which roughly half of enterprise output is dictated by state orders. The centralized supply system would be retained, with enterprises allowed to deal only at the margin in products produced above quotas. Less than one-quarter of Moscow bureaucrats favor giving enterprises freedom to set their own prices. The bureaucratic "reform" package falls far short even of the modest official proposals of the late 1980s. The stereotype of bureaucratic opposition to radical reform is accurate. In a society that has traditionally rewarded bureaucrats for agreeing with the official line ("perestroika will be a success"), it is remarkable that
less than half of Moscow bureaucrats feel that perestroika will eventually be successful.

The clear-cut identification of enterprise managers as the major beneficiaries of reform conceals an interesting ambiguity. Managers fear a move away from key features of the old system. The enterprise manager's fear of the unknown is understandable. In a chaotic system that mixes command and market elements, that assigns arbitrary prices, taxes away excess profits, and fails to assign clear property rights, who can predict whether the experienced manager's lot will be improved? Soviet managers would obviously prefer a well-functioning market system if presented a choice. Enough of them have seen it at work in Western Europe, Japan, and the United States. Managerial support for the more comfortable aspects of the old system reflects the lack of faith in the ability of the Soviet leadership to devise a nonchaotic system that combines market and plan.

Neither the Soviet bureaucrat nor the enterprise manager appears to understand how a market economy works. Sixty years of command system have taught both groups to think in terms of administrative balancing of supplies and demand. Goods are inherently in deficit. Shortages can only be eliminated by producing more. Raising the price has nothing to do with the "deficitness" of the commodity. Soviet bureaucrats believe in the visible hand of administrative methods. They openly worry about where the wheat, steel, shoes, and cigarettes will come from if they are not planned from above. In addition to personal concerns for their jobs and livelihood, Soviet bureaucrats are convinced that the economy could not continue to function in an orderly manner without them.

The limited economic reform that has taken place appears to have made things worse, as evidenced by declining growth, supply crises, hoarding, strikes, and rising inflation. The explanation is quite simple: Perestroika has dismantled much of the Soviet command system prior to establishing a new market order. The chaos associated with the erosion of the planned order threatens public and official support for radical reform. The Soviet public and the Soviet leadership may associate chaos with market reform rather than with the collapse of the com-
mand system. Moreover, the fear of the chaos inherent in a partial reform, could deprive the reform movement of its natural constituents, the industrial managers.

Can "command" be restored to an economy that has experienced the first steps of decentralization? Both enterprise managers and Moscow bureaucrats agree that local party influence over the economy has largely disappeared. They agree that the influence of industrial ministries and state committees has fallen considerably. Managers now pick and choose the directives they are prepared to implement. Ad hoc decisionmaking has replaced the old rules and regulations of the administrative-command economy.

We return to the issue of the optimal phasing of reform. The phasing chosen by the Soviet leadership has, obviously, not been successful. The Soviet leadership has chosen, as a first step, to dismantle significant elements of the command apparatus (most particularly the ministry command system) and to give enterprises new but restricted freedoms. Moreover, the local party command element has largely disappeared. The glue that once held the command system together has disappeared, and a new form of glue has yet to be put in place—namely, the discipline of the market.

The Soviet economy finds itself lacking disciplinary forces, either from the side of command or from the side of markets. The monetary control system that was previously based upon strict governmental and political control of monetary emissions has dissipated into an ineffective system designed to win political allies. Strict wage increase formulae (wages should not increase more rapidly than productivity) have been laid aside. Enterprises, with strengthened workers' collectives now set their own wage increases, still without a hard budget constraint. The central budget is in chaos because of the failure to resolve center-republic relations, and budget deficits must be covered by printing money. Strikes represent a thorny problem because market forces are not providing information on which wage requests to grant and which to deny.

These events cause one to question whether a cautious, phased reform will work. Moreover, it threatens loss of political support for
reform. The “cold turkey” approach, judging by the Polish experience, causes substantial output declines and a substantial upward movement in prices in the reform’s first phase. However, under the cold turkey approach, the eventual benefits should be felt in the relatively near future. This sense may allow public support for reform to endure the difficult first phase. Under the Soviet gradualist approach, a slow hemorrhage becomes a faster hemorrhage, and there is no end in sight to the problem. To expect public support for reform to continue in this environment is unrealistic.