Post-Soviet Economic Reforms in Perspective*

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The 15 sovereign states that replaced the Soviet Union in 1991 have begun a long and difficult transformation from socialist centrally planned economies to capitalist regulated market economies.

In this chapter, Schroeder analyzes how this transition is hampered by the ‘‘legacies’’ of Soviet institutions, development strategies, and economic policies. Next she considers the specific measures necessary to accomplish a successful transformation, including stabilization, liberalization, privatization, creation of a new legal framework, and restructuring of production. Then she examines steps taken so far in different successor states. She concludes with an assessment of the economic and political factors affecting the future progress of economic reforms in these states.

INTRODUCTION

The Soviet Union, which played such a fateful role in world history for more than seven decades, is no more: in December 1991 it was replaced by 15 independent states, 11 of them loosely associated in a new entity called the Commonwealth of Independent States (CIS). The new states are in the throes of a societal transformation unprecedented in nature and scope. In essence, they are experiencing three, thus far largely peaceful, revolutions: (1) the transformation of governance from dictatorial rule to rule by participatory consensus, (2) the transformation of the economic system from socialist central plan-

ning to one based on private enterprise and markets, and (3) the transformation from units in a highly integrated and centrally managed empire to fully sovereign nation-states. Given the unique legacies of failed Communism, successful completion of any one of these revolutions would be daunting. Together, they pose challenges of such scope and complexity as almost to defy comprehension, let alone succinct description of the ongoing processes.

As these intertwined revolutionary processes unfold in the coming years, the need to assess the progress of the three transformations will be ever present. Evidence of progress (or regress) will take the form of innumerable actions at all level of society and in all arenas—political, economic, and social. The cacophony of daily happenings will constantly need to be put into a perspective framework, so as to avoid premature judgments based on the headline event of the moment. In assessing the pace of change, such perspective requires a clear picture of the state of affairs at the outset and of the legacies of the past. It requires an organized outline of what the transformations require in terms of institutions and physical and psychological reorientations based on understanding of the necessary underpinnings of the desired new order. And it requires that reasonable expectations be formed regarding the ease, speed, and smoothness of such fundamental changes in societal institutions and human behavior.

This study aims to develop such a perspective, focusing on the economic transformation. First we review the key physical and institutional legacies and the shared experiences which define the economic starting point for each of the new states that have emerged from former Soviet republics. These states are widely diverse in history, culture, ethnic composition, resource endowments, and level of development. Next we outline what must be done to accomplish a successful economic transformation from central planning to markets—the declared goal of all 15 states. Then we describe what has been accomplished thus far, for Russia in some detail, and for the other states more summarily. The study concludes with an evaluation of that brief record, putting it in perspective and speculating about the ability of the post-Soviet states to meet the many critical challenges that they face.

THE LEGACIES OF SOCIALIST CENTRAL PLANNING: A COMMON INHERITANCE

The Soviet system of governance has left formidable legacies for its successor states. These legacies are to be found in the remnants of the institutions through which the economy was managed for many decades and in the habits and mindsets of the people whose behavior was molded by those institutions. Other legacies, perhaps even more terrible, stem from the development strategies that were pursued and are embodied in the physical capital stocks of each new state, in its land and its environment, and in the skills of its labor force. Related to those institutions and strategies are the legacies which are primarily the result of protectionist policies. Those policies insulated business firms not
only from foreign competition, but from domestic competition as well. None-
theless, the old system, despite its manifest flaws, did generate economic
growth, secular gains in living standards, and an extraordinary degree of per-
sonal economic security. To maintain perspective on the emerging new eco-
nomic orders in the successor states, one needs to keep in mind the totality of
the old monolithic order and its legacies, both good and bad.

Economic Institutions

Under the old regime, the economy functioned through a system that possessed
its own internal logic and through institutions that were closely interconnected
and mutually reinforcing.\(^1\) Virtually all productive property was owned collec-
tively, mainly by the state. Resources were formally allocated through cen-
trally dictated plans for production and associated physical allocation of mate-
rial inputs and capital to firms. Economic organization was hierarchical, with
firms and farms functioning essentially as the lowest level units in a bureau-
cracy. Prices were set administratively, changed infrequently, and served
mainly an accounting function (as was the case with money and bank credit).
Thus, prices, money, and financial variables played only passive roles in the
economy. Work incentives, while also job-related, were geared to meeting the
centrally dictated production plans. Finally, the formal institutions were sup-
plemented in practice by a variety of informal arrangements and behavioral
norms (both semilegal and illegal, but marketlike in character) that on balance
facilitated the functioning of the formal arrangements which proved to be so
deply flawed in practice. This so-called "second economy" functioned in the
sphere of production as well as in consumption. Queuing and black markets
were perennial features of everyday life.

The presence of these institutions meant that socialized property became
nobody's property, with no one having a personal stake in maximizing its
income stream and its value over time. It meant that firms throughout the
production-distribution chain were oriented vertically toward satisfying their
organizational superiors rather than horizontally toward pleasing their suppli-
ers and customers. It meant that prices became accounting units which re-
lected neither relative costs nor relative scarcities even tolerably well. It meant
that money was not real money in the sense of a universal carrier of options to
buy goods and service of one's choice. It meant that there were no capital and
financial markets and that banks acted essentially as accounting and money
transfer agents for the government. Workers were educated and trained in the
service of this institutional milieu. These institutions are the polar opposites of
those characteristics of a well-functioning market economy.

\(^1\) For discussion of this point see, in particular, Alastair McAuley, "Central Planning, Market
Socialism, and Rapid Innovation," in Technology Transfer and East-West Relations, ed. Mark E.
Soviet-Type Economy: Nature of the System and Implications for Reform," Journal of Economic
Perspectives 5, no. 4 (Fall 1991), pp. 11-28.
Development Strategies

A hallmark of Soviet development strategy was its long-continued addiction to unbalanced growth of the economy. To mobilize resources for economic growth, investment was pushed to a near-maximum at the expense of consumption. From the outset, investment was allocated disproportionately to the industrial sector, and within that sector to heavy industry and defense at the expense of consumer goods industries. Agriculture and the service sectors were relatively neglected, although in later years investment was directed disproportionately to agriculture as the perceived panacea for its perennial shortcomings. Moreover, Moscow-dictated regional development policies fostered specialization rather than diversification in each republic. The outcomes of this strategy are to be seen in the pattern of land use, in the nature and location of the physical capital stock, and in the deployment of the work force in each of the successor states. These are the physical facts of life with which they necessarily must begin their independent course. To one degree or another, their economies begin with overblown and distorted industrial sectors, unduly large amounts of resources tied up on farms, and grossly backward service sectors, where the accumulated backlog of neglect is awesome to behold.2

To speed up economic growth and to compensate for the manifest inability of Soviet-style institutions to economize resources, a mobilization strategy was pursued. Capital stocks were accumulated beyond the point of diminishing returns and at excessive costs in terms of consumption forgone by the population. Working-age adults were drawn into the labor force to such an extent that labor force participation rates are a near-maximum. Land was deployed and natural resources employed in the service of production, with scant attention paid to the environmental consequences. By the time of the Soviet Union’s demise this growth strategy was no longer viable, and its legacies are visible and formidable. They are found in massive and largely obsolescent stocks of machinery, equipment, and buildings (often unsuitably located); in the fact that almost everyone has some job which is regarded as a right; and in the parlous state of the environment. These are other characteristics of the physical inheritance, in varying degrees and configurations, of each of the successor states.

The Ultimate in Protectionism

The foreign trade institutions and policies in place in the USSR over many decades effectively shielded producers from all foreign competition. Within a general policy of trade aversion and, after World War II, a strong orientation toward trade with other socialist countries, Moscow planners decided what products were to be imported and in what quantities. The idea that imports should be used to spur efficiency in firms was completely alien. Rather, imports

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2 These and other severe economic distortions brought about by socialist central planning are described in Jan Winiecki, The Distorted World of Soviet-Type Economies (Pittsburgh, Pa.: University of Pittsburgh Press, 1988).
were obtained to fill gaps in domestic production essential to meeting overall plans. Procurement of imports through specialized government agencies and their allocation through supervising ministries also meant that business firms were insulated from contacts with their foreign suppliers. A bias toward import substitution figured importantly in planners' decisions about the expansion of domestic production capacities.

Similarly, firms were protected from having to try to sell their products on foreign markets. Planners decided what part of a firm's output was to be exported, and, if need be, accorded the firm special benefits to make its products salable abroad. In any case, the firm knew that whatever was not exported would be allocated to domestic customers. Exporters did not deal directly with their foreign customers, but instead, with state bureaucracies. In general, exports were viewed as a necessary evil, the price that had to be paid for unavoidable imports.

The protected environment for Soviet firms was enhanced by the fact that the bulk of trade throughout the postwar period was conducted within the framework of the Council for Mutual Economic Assistance (CMEA) trading system. Essentially, under that arrangement Soviet energy and raw materials were bartered for relatively inferior East European machinery and manufactures. It was a system of largely captive markets, in which sizable mutual economic interdependencies developed, but without the necessity to settle accounts in real money (hard currency). The accrued production interdependencies made all CMEA members and their firms highly vulnerable to any move to end the captive markets.

Extreme protectionism for business firms extended to the domestic arena as well. Firms did not have to compete with one another for customers or even to find them. Rather, a firm's products were "sold" or, more aptly put, "distributed" for it via its plan for "sales." To make matters worse, many firms were endowed with the ultimate in protection—monopoly or near-monopoly in the production of particular products. This ubiquitous situation arose from planners' misguided notions about the economic efficiencies to be had from concentrating output in giant agglomerations. The legacy of such policies is a world of monopolies. For example, according to Soviet data for the late 1980s, more than one third of all important machinery products (such as sewing machines, tram rails, and locomotive cranes) was made by only one producer, and another third was made by only two firms.3

This policy of "gigantomania" created large and critical interdependencies, which were reinforced in their geographical impact among republics by the central government's regional development and industrial location policies. These policies fostered specialization rather than diversification in each republic. Plants were designed and sited predominantly in the interest of the country.

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3 These and a variety of other statistics showing the high degree of industrial concentration in the Soviet Union are cited in Heidi Kroll, "Monopoly and the Transition to the Market," Soviet Economy, 7, no. 2 (April–June 1991), pp. 143–74.
as a whole. In a sense, this approach maximized inter-republic trade in an institutional setting that permitted firms to exchange their products in a highly protected market—another "captive market," in effect. As with foreign trade, these exchanges were arranged by state bureaucracies (mainly the industrial ministries and the State Committee for Supply) rather than by the firms themselves. Again, this situation made each republic and its producers highly vulnerable to dissolution of the internal Soviet market. To cite only one set of statistics characterizing the mutual vulnerabilities, in 1989, imports (domestic and foreign) provided from 15.7 percent (Russia) to 31.0 percent (Armenia) of republic consumption, and exports accounted for from 10.7 percent (Russia) to 27.1 percent (Azerbaijan) of republic production. These mutual trade dependencies are deeply embedded in the production profiles, capital stocks, and labor skills in each new state and cannot be altered in any major way in the short run.

Finally, enterprises as well as republic governments themselves were insulated from bankruptcy or insolvency through a complex network of monetary transfers and by the highly centralized financial system. Firms did not have to seek out investors or banks to obtain new capital; instead, funds were supplied to them virtually without charge. If firms ran into financial difficulties, they could expect to be rescued by their parent ministry. Bankruptcy and closure because of insolvency were unknown. Republic governments did not have to concern themselves with raising revenue and balancing their budgets. Rather, their role was to administer budget revenues and expenditures largely determined for them by the central government. Whenever planned expenditures exceeded allocated revenues, the central government simply re-jiggered the flows or provided subsidies. If republic governments wanted to increase investment or social expenditures, they needed to lobby the fiscal authorities and central economic ministries in Moscow.

Individuals, too, were protected from economic vicissitudes. The state guaranteed jobs for everyone who wanted one. School-leavers could rely on the government to find them their first jobs. Reinforced by the fact that much housing and many welfare benefits were provided by employers, workers came to regard their particular jobs in particular firms as economic rights. Housing, health care, and education, although rationed in various ways, also came to be provided as social rights with only nominal charge, if any. To a large extent, a job entitled the employee to housing, recreational facilities, and social benefits financed by the employer. Social security systems provided income for the aged, the disabled, and families who lost a breadwinner. Finally, after World War II the rate of inflation was low, wages rose much more rapidly than prices, and social benefits were increased periodically. Such was the relatively secure

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and predictable milieu that most people came to value and to associate with socialism.

**Economic Performance**

Although nowadays almost universally discredited, the socialist production system proved able to generate fairly steady economic growth, albeit at markedly declining rates after 1975. According to the best measures available in either East or West (those of the U.S. Central Intelligence Agency), annual growth of GNP averaged 3.4 percent for the 40-year period 1951–90. Growth was positive in every year but three—1963, 1979, and 1990. But while growth rates averaged about 5 percent in the 1950s and 1960s, the average rate fell to 2.5 percent in the 1970s and to 1.2 percent in the 1980s. Over the whole period, however, the Soviet growth rate was not able to keep up with Western Europe’s, and it even ceased to gain on that of the United States after 1965. These relationships held true on a per capita basis as well. Thus, so-called “development gaps” were widening quantitatively and, as is now becoming ever more evident, qualitatively as well.

Moreover, in the postwar period, the Soviet people saw their lot improve dramatically, albeit from very low levels. With the higher priority accorded to consumption by post-Stalin leaderships, per capita consumption grew rapidly, registering an average annual growth of 2.8 percent during 1951–90. Again, however, the pace of gains in living standards slowed markedly—from a total gain of 35 percent in the 1950s to a mere 9 percent during the 1980s. Although “consumption gaps” with the West were widening, especially in qualitative terms, the Soviet people were able to perceive steady and palpable improvements in their living standards over the years in terms of more and better food; more clothing and footwear of more modern design; fast-growing stocks of consumer durables, including much-coveted automobiles; more spacious housing with more amenities; and additional services of many kinds. Antiquated though it was by Western standards, the USSR’s cumbersome retail distribution system did manage to make most daily necessities available for purchase most of the time, at least until the end of the 1980s. While queuing was commonplace, people found a variety of ways to better their lot through informal channels. Judging from an extensive Western survey of Soviet emigrés, people were moderately well satisfied with their overall standard of living. The significance of all this is that in the midst of today’s turmoil, people can remember that socialism did work after a fashion.

Also part of the performance legacy of socialist central planning, however, is the fact that those gains in economic growth and living standards were

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obtained at grossly excessive costs relative to the Western experience. Unlike in the West in general, Soviet growth was fueled by a massive buildup of capital stock, near-maximum mobilization of the population into the work force, profligate use of energy and raw materials, and an almost total disregard for the environmental consequences of what amounted to a policy of production at any cost. Whatever the disputes over the numerical calculations, it would be generally agreed that improvements in productivity beyond those embodied in the capital stock and a better-educated work force contributed little, if at all, to Soviet growth—a situation markedly different from Western growth experience. Also, it is now generally agreed that the “technology gap”—as reflected in the quality and modernity of the physical technologies and processes used throughout the Soviet economy, and therefore embodied in present stocks of machinery and equipment—is large relative to the West and has been widening in recent years. There is no dispute either that the energy and raw materials intensity of Soviet production technologies exceeds those in the West by wide margins. This lamentable outcome is mainly the result of the fact that technological progress had to be “introduced” from above, because the system lacked incentives to generate it from below. Finally, observers agree that damage to the physical environment and to human beings has been inordinate; witness is given by the Chernobyl disaster and the title of a recent book, Ecocide in the USSR: Health and Nature under Siege.8

A Treadmill of Attempts to Reform Socialism

Although the debilities of socialist central planning were visible from the start, they had become ever more evident by the mid-1960s, as economic performance indicators began to worsen and the sources of extensive growth began to dry up. Soviet leaderships from Khruşčev through Gorbachev believed that remedies could be found through within-system reforms. Their numerous actions were intended to make the system more efficient while leaving its essential features intact. Since it was those very features that influenced the behavior of economic agents and therefore economic outcomes, such efforts amounted to trying to square the circle and they came to naught.9 Despite the

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perennial changes, and perhaps to some degree because of them, economic performance worsened. Until almost the very end of this process, there were three untouchables—the role of the Communist Party in the economy, the Communist system of property, and government determination of most production and prices. Within that framework, the numerous tinkering reflected a ceaseless search for panaceas in three areas—economic organization, planning routines, and the degree of autonomy to be accorded to firms, along with incentive schemes for their managers.

Planners seemed to believe that discovery of the "ideal" arrangements for economic organizations would solve the economy's problems. The ensuing search and experimentation concerned (1) organizational relationships between the central government and republic and lower-level administrative units, (2) the structures of the economic bureaucracies, and (3) the organizational structures between these bureaucracies and the enterprises. The permutations and combinations that were tried out almost defy description. Some changes were major, such as Khrushchev's replacement of nearly all of the central economic ministries in 1957 with regional economic councils, and Brezhnev's subsequent restoration of the ministries in 1965. Also important were Brezhnev's drive in the 1970s to amalgamate enterprises into large associations and Gorbachev's establishment of seven supra-ministries (bureaus) during 1985–87 to coordinate the activities of several ministries with similar products or functions. Other innovations were of less consequence but were ubiquitous. For example, Gosplan underwent many reorganizations over the years; the responsibilities for central rationing and pricing were handed about; the number of ministries was increased and then decreased; ministries were divided and then reunited; ministries were shifted from all-union to union-republic status and back again. Through all this, the basic formal organizational structures endured, until Gorbachev's innovations brought about their destruction.

Another theme that prevailed the saga of reforms was the planners' seeming conviction that finding the "perfect" plan and planning routines would lead to similarly "perfect" performance by executants. In search of the optimal plan, postwar planners turned to modern computer technologies and mathematical models. Alterations were often made in planning procedures and routines. The number of plan targets set centrally for firms went through cycles of being decreased and then increased. Specific targets were redefined to make them more "scientific." Terminologies were changed—from mandatory "plan targets" to mandatory "state orders." Procedures were periodically altered in efforts to resolve the perennial tension between "branch" and "regional" planning. Planning through "program-goals" approaches and comprehensive planning for key industrial "complexes" and regions were added to Gosplan's burden and superimposed on the ordinary routines. The feebleness of the persistent efforts to make central planning work better is shown by a growing divergence between plans and actual results. In the final Soviet 5-year plan (the twelfth) for example, the plan called for an average annual growth of 4 percent in GNP, but the rate achieved was less than 1 percent, as was also true for
industrial production, for which average annual growth of 4.6 percent was targeted.

A third focus in the treadmill of within-system reforms was the degree of autonomy that should be given to enterprises and the design of incentive schemes for their managers. The situation was one of ebb and flow, in which the planners broadened the decision-making authority for firms in varying degrees and areas, and then retracted all or parts of the newly delegated authority. Although by no means removed from the dictates of their ministries and central plans, firms were given by far the most extensive delegation of authority when Gorbachev's 1987 package of reforms introduced a new Statute on the State Enterprise. In the growing macro-disarray of the late 1980s, firms in practice were able to exercise ever more independence. They found that they often could ignore the frantic efforts of their superiors to rein them in, and the behavior of firms contributed importantly to bringing down the system of centralized planning.

The frequent changes in the permitted autonomy for enterprises were accompanied by alterations in the criteria for assessing their success and rewarding their managers. While Stalin and Khrushchev focused almost single-mindedly on meeting plans for production in physical and value terms, their successors in their successive packages of reforms tried out a seemingly endless number of other combinations. In the 1965 package, meeting the plan targets for key products in physical units was still required, but bonuses were made dependent on targets for sales and profitability. When that complicated scheme did not bring the desired results, other criteria were added—notably meeting plans for labor productivity and improved product quality. Later, the emphasis shifted to contract fulfillment as the principal criterion for success. In effect, the planners sought to devise schemes that would induce socialist firms to increase production, improve efficiency across the board, improve the quality of products, and pay attention to customers. In a word, they were attempting to elicit capitalist behavior from socialist firms without placing them in a capitalist environment. This was one more failed attempt at squaring the circle.

**Ending the Treadmill of Soviet-Type Reforms**

While Mikhail Gorbachev was fond of characterizing his reform initiatives taken before 1990 as both "radical" and "revolutionary," as formally laid out they were neither; in fact, they were a continuation of the decades-long treadmill. But they did contain elements of radicalism, and they set in motion forces that unintentionally catapulted the Soviet economy off the venerable treadmill and into an era of reforms that in concept really are both radical and

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