

L.5.2

RFD 527

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

February 9, 1965

Problems of Communist Economic Systems

11 pages

Paul Gekker

Text of a pre-recorded radio talk in the series "The Communist World," presented by the faculty of the Institute for Sino-Soviet Studies of the George Washington University, and broadcast on Sunday evenings during fall and winter 1964-65 by Station WTOP, Washington, D.C. This radio talk was broadcast on January 31, 1965.

February 9, 1965

Paul Gekker

Problems of Communist Economic System

I

In thinking about problems of Communist economic systems it helps if we begin by making some basic points perfectly clear. It is usual to say that the operation of the economy in Communist countries cannot be considered apart from the political environment. Certainly the political basis, and the ideological underpinnings of economic policy in Communist countries, are direct and specific. This does not mean that economic decisions in these countries are necessarily arbitrary, in the sense that they are taken in ignorance of economic realities, or in defiance of what people like to call "economic laws." But from the generally correct view that political factors are overriding it is tempting to say that there is no separate economic problem to be studied in countries under Communist rule.

Nevertheless there is a perfectly straightforward way of studying Communist economic systems, a method which incorporates the political framework as an integral part of the analysis. In this exercise, we usually take the economy of the Soviet Union as the standard model, for the natural reason that this is the Communist country in which a planned economic system, designed to implement politico-economic tasks laid down by the central political authorities, has been in operation for the longest continuous time.

The difficulty with this choice is that, from one point of view, the Soviet economy is something of a unique case. This is not simply a

matter of recognizing that economic systems in smaller Communist countries (in Eastern Europe, for example) are not now carbon copies of the Soviet blueprint -- if they ever really were. What it does mean is that economic consequences of a special kind follow from the sheer size of the Soviet continental land mass, just because this geographic expanse carries with it an abundant and varied resource endowment. How and why such resources are used is a separate question. In addition, of course, the geopolitical role which this giant nation-state -- either as Russia or as the USSR -- seems destined to fill has economic consequences we need to bear in mind.

Leaving that consideration aside, however, the obvious point is that the existence of rich natural resources creates something like a natural predisposition toward economic self-sufficiency. A country enjoying resource self-sufficiency is in a position to obtain a good many of the benefits of the division of labor and the specialization of economic activity by its unaided efforts, without the "bother", so to say, of foreign economic entanglements. Stated differently, self-sufficiency attributable to the existence of a rich endowment in natural resources implies the possibility of pursuing domestic economic policies which, within fairly wide limits, avoid or ignore the economic constraints of living in a world of interdependent national states.

We cannot do more than hint at this general implication of differences in geographic size and resources base that characterize the Soviet Union, on the one hand, and the smaller Communist countries, on the other. Besides the Soviet Union, of course, only Communist China is even remotely comparable by this standard; but as we know, China is in an earlier stage of economic development. But if the distinction based

on the economic consequences of size is a valid one, it may help us to identify the economic, as distinct from the political, basis for the disarray that has become increasingly evident in the Eastern European area.

## II

To return to our main theme: if we take the perfectly reasonable position that political goals in Communist countries are given, how can we best describe the economic systems devised to fulfill these goals? Better still, how can we distinguish a Communist economic system from other working arrangements designed to perform generally comparable economic tasks?

One distinction people point to is the degree of government ownership of the means of production. Others prefer to think that the difference hinges on the use of economic planning, certainly a recognizable hallmark of Communist systems. Now it is true that in Communist economic systems the extent of government ownership, and the application of planning, go far beyond anything of this kind in non-Communist countries. But a few moments' reflection will show that, even so, these are not the chief distinctions. Nationalization in some economic sectors is common enough in a great number of non-Communist systems and so, for that matter, are elements of planning. But nobody maintains that because the railroads are owned and operated by the government in Switzerland or in Germany, for example, or because economic plans and planning techniques of sorts are in use in, say, France and the Netherlands, the economic systems in these countries are sub-species of a general type which also includes Communist economic systems.

We have to look elsewhere for the chief distinguishing mark. Economists have suggested that it lies in the role assigned to the market. The distinction is now so widely recognized that we speak of Soviet-type (or centrally planned) economies, on the one hand, and of market-oriented economies, on the other. In the latter, most decisions are made with reference to market forces and are carried out through the market mechanism. In Soviet-type economies the principal economic decisions ignore the market. It does not perform its accustomed function in collecting information and transmitting impulses that are translated into decisions affecting the allocation of resources, the division of effort between present and future needs, and the production and distribution of goods and services in the economy. In Soviet-type economies, markets play a peripheral role; they have been thought of, until now, as transitional or sometimes just vestigial arrangements.

The distinction may also be thought of in terms of the degree of interference exercised over economic activity. Even in market-oriented systems, of course, there is substantial variation in the amount of such intervention that is actually practiced or that would be acceptable. Also, intervention as it is practiced in our systems is designed essentially to modify market forces in varying ways, but not to replace them. Short of exceptional circumstances, which means in time of war, no attempt is made to construct an administrative apparatus to substitute for normal market forces.

If Soviet-type economic systems are not market-oriented, techniques developed by economists to study the effects of markets and market forces would not seem terribly relevant or useful. We need, one

would think, a different analytical framework for studying Soviet - type economies. In such systems, as we suggested at the beginning, the economic system is a creature of the political structure, and serves articulated political ends. The goals that are supposed to govern the operation of the economy therefore measure essentially the policy makers' wishes. This is a far different thing, of course, from viewing the economic system as a mechanism for realizing the myriad and separate decentralized plans of countless decision makers. But it does not require us to discard all our analytical techniques; in fact, they have to serve as a partial guide to tell us what would be happening in a system that is designed to a large extent to circumvent the operation of market forces.

### III

The essence of this very different system can be simply stated. The virtual elimination of the market as an economic guide and regulator and the substitution of detailed and centralized planning require the adoption of complex economic controls. They also require the creation of a vast organizational apparatus to get the assigned tasks done. The sorts of problems we can identify with Communist systems are almost a natural outgrowth of the all-embracing bureaucracy that is the heart of this politically motivated economic structure.

To complete this picture we need to outline briefly the political ends which these centrally directed systems are commonly designed to serve. We can usefully adopt Professor Campbell's definition, which crystallizes the basis of the centrally planned economy. "The Soviet economy," he writes

"is totalitarianism harnessed to the task of rapid industrialization and economic growth." Glossing over some important and interesting specifics, his definition is a generally accurate description of all such systems.

These twin objectives, rapid industrialization and economic growth, require a fairly drastic policy orientation. In the Soviet case, industrialization historically implied a single-minded concentration on building the basic sinews of industrial power, involving the transformation of a predominantly agricultural and largely underdeveloped country into an industrial power of the first rank. It was a task of herculean proportions and it was achieved, as we know, at fearsome cost. The development of other Communist economic systems, is, of course, much more recent; but the policy orientation is not essentially different from the one applied in the earlier Soviet example.

The construction and expansion of an industrial power base also requires the diversion of a large share of resources from current consumption to capital investment. In addition, the Soviet-type system requires that this investment be concentrated to the greatest possible degree on heavy industry, on the production of producers' goods, at the obvious expense of sectors serving the ultimate consumer. It is useful to remember that this kind of growth, which Communist writers call euphemistically the "planned, proportional development of the national economy" is, by our standards, planned economic imbalance.

The process we describe is almost a capsule description of economic growth, a view which suggests that there is no particular secret about the formula in Soviet-type systems. The central planners understand that a high economic growth rate -- which, incidentally, is also a matter of defining and

measuring things in a special way -- will be achieved by devoting a large share of resources to investment. Under investment, of course, we want to include investment in human resources, that is, education and training, as well as research. The planners also understand that sustained growth requires the plowing back of resources into more investment, into what economists like to call growth-inducive sectors. What is meant by this criterion is that investment in steel production contributes more to output growth than resources put into housing (also a form of investment), not to speak of resources put into food production, which serves only current consumption.

What about the bureaucratic machinery required to put this policy orientation into practice? There are a number of terms in common use nowadays that serve very well to convey the idea behind this large organizational machinery. One speaks of the "command economy," a term made popular by Professor Grossman who, in a recent perceptive study of this special system, reminds us that command economies do not arise spontaneously but are imposed. In any event, there is the organizational machinery guided at every level by the political authorities (the Party), which is supposed to insure the implementation of the planned tasks.

Some other features are interesting. Observers of the "command" system have particularly noticed the widespread use of military, or quasi-military terminology -- there is much talk of "storming," of "mobilizing" resources or "reserves," of never-ending "campaigns" for the furtherance of some economic objective or other. Observers are also struck by the fact that the management of these systems requires a very liberal dose of exhortation. The system, in brief, often seems committed to a type of frenzied activity that substitutes for the simplest functions of the market mechanism. Finally,

because the system is also a mechanism for surveillance, verification and control -- of people watching people -- it strikes one, in the apt words of one American visitor, as a species of "togetherness gone mad."

#### IV

Now all of this is not intended as a caricature, except insofar as a speaker tries to dress familiar phenomena in somewhat picturesque language. All of these things can be thoroughly documented from Communist economic writings. And lest we be accused of an undue preoccupation with the pathology of Communist economic systems, let us willingly admit that the system is capable of impressive achievements. Whatever the means, it can marshal resources -- human, material, financial -- and devote them un- sparingly to the complete achievement of any task deemed sufficiently important. That, clearly, is the lesson to be derived from the dedicated Soviet space effort.

But our topic is economic problems, which we can list in as much detail as we please. In a bird's-eye view, obviously, we can focus only on the most important and speak of them only in the broadest terms. On this basis, we can concentrate our attention on problems in two broad groups: problems associated with agricultural effort, and trouble areas in the field of industrial management and control, which include problems relating to the satisfaction of consumer needs. These are very broad categories, to be sure, but it is important to emphasize that they are not separate but inter-related; that problems overlap, and are both cause and effect.

Problems in the field of agriculture appear to be endemic to Communist economic systems. This is an area in which economic decisions are uniquely guided by political considerations. It is not that the planners

are unaware of agricultural problems or that they would not wish to solve their difficulties if they could. But the planners have more important objectives; and because they wear special ideological blinders, they cannot bring themselves to take those commonsense steps that would result in adequate gains in farming. Almost everywhere, and with few exceptions, the authorities are hobbled by ideology from recognizing the need for adequate incentives. Some increased commitment of resources to agriculture has taken place in Communist countries in recent years, but it has been grudging and insufficient. By and large, planners have tended to favor "crash" programs and hasty "campaigns," which have usually run to excess because of indiscriminate application. Whenever weather conditions have been favorable, the costs of such programming efforts could somehow be justified and borne. When, as in 1963, weather conditions were adverse, the results have been little short of disastrous. When all the reservations have been made, the truth is that Soviet-type economic systems have not proved capable of providing an adequate diet for their people. In the Soviet case, at least, this covers a good slice of history.

The problems one can identify in the field of industrial organization and management are especially significant because the industrial sector is, after all, the traditional heart of the planned system. It is here that the commitment to growth finds its application; it is here we look for the priority sectors of the economy; it is here, one would suppose, that there can be no question of conflict between goals and results, or inability to fulfill assigned plans. Yet in this field recent years have witnessed a multiplication of problems which have been reflected in a general retardation of earlier high growth rates.

The existence of difficulties in the favored and seemingly invulnerable industrial field is not the paradox it appears to be at first sight.

The obsession with forced economic growth means that resources are over-committed everywhere and at all times, that the goals exceed the capabilities for realizing them. Some goals, like consumer goods targets are perhaps not really meant to be taken too seriously; the under-fulfillment of consumer goods goals has been a steady and predictable phenomenon throughout the Soviet planning era. But in priority industrial sectors the "command" economy is always under strain, always taut, always -- to quote Professor Grossman again -- "rooted in the logic of haste." In other words, the system works under little or no visible slack and, for this reason, is beset with a host of difficulties and problems which are aggravatingly persistent. The condition can be generalized by thinking of the position of the key person in this system, the manager of the industrial installation, on whom the main burden for realizing the plan in its details falls. The industrial manager works in an atmosphere composed of intense pressures from above to accomplish all sorts of planned tasks fully and on time while, at the operating level, he struggles with the shortages, the malfunctioning of supply and distribution, the reconciliation of conflicting objectives, large and small.

These problems have always existed in the planned system, but it is only recently that they have begun to exert cumulative and serious effects on growth itself. The reason is that the Soviet economy -- and this applies to some extent to the other Communist economic systems as well -- has passed the early stages of industrial transformation and has become much more mature, more complicated structurally and more diversified geographically. As contrasted with a simpler -- certainly a more "heroic" -- stage, if once can put it that way -- the greater range of choice in this

more mature economy has made decision making much more complex and has forced a continuing search for practical methods of improving the operating efficiency of the economic machine.

So far the efforts to meet the persistent problems of this tight, over-extended economic system have taken the form of organizational experiments, of attempts to cure the difficulties by changing the formalized channels of command back and forth -- first in the direction of "decentralization," by the devolution of some decision-making powers, then by "re-centralizing" just as soon as tendencies toward economic untidiness threatened to get out of hand. It is noteworthy that this effort has been accompanied, in the Soviet Union at any rate, by the adoption of increasingly harsh and punitive legislation, involving the death penalty in some cases, for what are termed "economic crimes."

But more recently, the leaders in Soviet-type systems have begun to recognize that solution of their economic difficulties requires a more sensible approach to the question of economic incentives; and there has been, as almost everyone knows, quite a bit of talk about adopting more intelligent economic indicators, such as profits. In a recent article, Professor Herman summed this all up in a persuasive way. The Soviet authorities, he wrote, "must abandon the magic horse of hypertrophic growth and settle down to learn the homely art of economic calculus." They will find it imperative, Herman suggested, to clean the economic house "of the cobwebs of bad practices that have accumulated during decades of hypnotic preoccupation with...the physical aggrandizement of the industrial establishment."

A humanist who thinks about such questions can only express the hope that this process comes soon and is thoroughgoing; for it is only in that direction that any case for cautious optimism over the long term can reasonably be made.