

# Soviet Restructuring in Relation to the Chinese Reform

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## I. The Genesis of 'Taut Planning'

In the early 1950s all states with a ruling Communist Party had adopted a homogeneous economic mechanism — that of the USSR. The Soviet 'command economy' had been constructed within a very short space of time — the single year 1930 embraces most of the essential changes — and responded to the political dictates of centralized authority. That authority was constituted by Stalin himself and it can be argued that, having assured political autocracy, he would not tolerate the persistence of economic forces which might gainsay him or undertake activities contrary to those embodied in a central plan. The forcible collectivization of the peasantry and the elimination of private small-scale industry and trade removed from the economy all those whose performance was geared to the domestic market. Soon afterwards, the same exclusion was applied to those who responded to changes in foreign markets: by 1938 a deliberate policy of self-sufficiency had reduced exports to a mere half-a-per cent of Soviet GNP (Holzman, 1963: 290). The political imperative did not render such exclusive centralization irrational for economic development, for it could be contended that all resources were thereby mobilized to achieve a few crucial outputs, such as the expansion of capacity for engineering in order to provide capital equipment and defence goods, and for that new capacity to be supplied by energy, steel and other inputs and housing, food and clothing for the workers. Such concentration of economic activities on a narrow set of objectives was later characterized by a famous Polish economist as a '*sui generis* war economy' (Lange, 1961: 139).

That observation is relevant to the hostile external environment in which Stalin's form of central planning was adopted in Eastern Europe and China. By 1951 each of the seven states ruled by Communist Parties in Europe<sup>(1)</sup> had adopted five- (or six-) year plans on the Soviet model

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(1) Mostly as a consequence of mergers with socialist parties in 1948 or

with similar apparatus for their implementation, notably nationalization of industry, transport and trade, compulsory procurement in farming (collectivization had, however, only barely begun) and the monopolization of foreign trade. Albania, Bulgaria, Czechoslovakia, the GDR, Hungary and Romania were in the early phases of such plans and were members with the USSR of their own economic group, the Council for Mutual Economic Assistance (Comecon); Yugoslavia was nominally within the period of a five-year plan, 1947-51, but was abandoning centralization and nationalization for worker self-management and a 'socialist market'. With the exception of Yugoslavia, the communist-governed states confronted the rest of Europe in the Cold War and were soon to respond to the North Atlantic Treaty by their own military pact, the Warsaw Treaty. The Chinese Communist Party by its victory in 1949 over the Guomindung in all China save Taiwan was in armed conflict on its borders — Korea and Taiwan — and was under censure by the United Nations. Mongolia had started its first five-year plan in 1948; North Korea and North Vietnam began two-year plans in 1949 and 1955 respectively (see Kaser, 1967: 66). Even if Stalin had not pressed its system on his east European allies, Mao had not welcomed Soviet economic advisers, and had other Asian communist parties not fallen into line, the hostile environment would have rendered rational the adoption of planning for a war economy.

The belligerency of the Cold War is now part of history although relations between Communist-Party ruled and non-communist states can still be tense. Conferring here in Seoul, one cannot but be aware of the closed frontier to our North and of the shooting down not so long ago of a Korean airliner as it flew towards this city. There are indeed some in the armed forces and in defence industries who argue for the continuance of central planning as assuring their charges the priority in supply which they long enjoyed. But even they would accept that their governments' objectives in allocating economic resources cannot be exclusively military; moreover for some years they have been told that a strong, broad-based economy is needed to underpin their material provision.

The widening of the economic objectives of a ruling Communist Party since the days of Stalin and Mao — notably to obtain the gains of international trade and to satisfy the diverse and growing demands of households — is one part of the indictment of 'taut' central planning. The other part is the waste of resources occasioned by the use of so unsophisti-

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thereabouts, some Communist Parties had changed their names and the designation they collectively adopted was 'Communist and Workers' Parties.'

cated an economic mechanism. Macroeconomic ranking by simple priority and the microeconomic maximization of production are emanations of a supply-determined system. Although under capitalism the macroeconomy can be characterized as 'demand-determined' (at least within the Keynesian analysis), its microeconomic equilibrium is of course the outcome of both demand and supply conditions. In Eastern Europe and the USSR 'extensive' development — that is growth by the addition of manpower, capital assets and natural resources — is being forced out (by a stringency of labour and the moderation of a high investment propensity) in favour of 'intensive' development — that is the improvement of the efficiency of currently-exploited factors of production. Mongolia and Cuba (which went through a period of extreme 'priority' planning in the 1960s) once had large rural manpower reserves upon which to draw for 'extensive' development but in both countries the majority of the population is now urbanized (71 per cent in Cuba and 52 per cent in Mongolia). China can still foresee a wealth of human resources — the population of working age will rise from 585 million in 1980 to 761 mn in 1990 and 850 mn by the year 2000 (a rising proportion of the total population from 59.7 through 69.6 to 71.1 per cent) on estimates by the World Bank (1985, Tables 8.2 and 8.3, Projection B). Yugoslavia (with 600,000 workers abroad and nearly one-fifth of those at home unemployed) and Albania (with the highest demographic growth in Europe) are not yet faced with a labour shortage, but their ruling parties have chosen economic structures (extreme devolution in the one, extreme centralization in the other) which are of little help in a comparative analysis of Soviet and Chinese reform. Soviet-type planning made large areas of economic activity irrelevant to the equilibrium analysis of market economies: Stalin's slogan to 'overfulfil the production plan' and Mao's maxim of 'self-reliance' were two sides of the same priority for supply conditions — the former maximized outputs, the latter minimized inputs.

## II. A Market in Farm Produce

A first stage in reform is hence to moderate the effect of taut supplyside planning by applying the influence of demand conditions. Both China and the USSR began by fostering responsiveness to market-expressed demand in agriculture. The commune as an entity monopsonizing the labour of its conscribed membership have been replaced by village councils and a 'contracted household responsibility system' which allows the farm household to be remunerated according to the output of the land, livestock or craft to which it applies its labour. Property rights remain limited in two

ways. First, some obligatory procurement contracts are still imposed, but the average quota was reduced from 70 to 30 per cent of the expected crop in 1985. Secondly, the land is at its disposition (for as long as thirty years), not in its ownership, but as a right to usufruct which is saleable, together with the value increment occasioned by any capital improvements it may have made. Farm output has flourished and the flow of produce to the towns has furnished backing for incentives among the non-farm population. The collective and state farms in the USSR remain but since 1981 the 'contract brigade' has spread among the former. Such a brigade is normally small and confined to a family-related group; unlike the brigade which has been units of collective farms since their creation, their membership is self-chosen and they select their own leader and work schedules (Gagnon, 1987). As in China they are remunerated by results, but their regular tenure of the same piece of land or herd of livestock is not as firmly guaranteed. Nor have they developed as rapidly as their potential demands. Gorbachev at the June 1987 Central Committee meeting complained that 'the family contract system is insufficiently widespread, although the efficiency of these forms of organization of, and payment for, labour is high enough' (Gorbachev, 1987). The Director of the Institute of Economics of the USSR Academy of Sciences has cited the success of Chinese agricultural reform in urging that, while retaining more of the collective framework than in China, 'we should energetically encourage the development of the family form of labour' (Abalkin, 1987a). Soviet families are being urged to till more intensively the plots around the farm homestead and to sell their produce on town markets (Schmelev, 1987). The collective and state farms for which they work have been instructed to sell the fodder and young livestock which such production requires.

Under a 'law on the enterprise (association)' enacted by the Supreme Soviet in June 1987, state farms will be able to sell some of their farm produce (and all of their non-farm production) outside the state supply system; collective farms have recently been allowed to sell up to 30 per cent of their output on the free market.

Both China and the USSR have established 'agro-industrial' agencies which link farming with the production of its inputs and with the processing of its outputs. Each phase is thereby rendered more sensitive to derived demand. The opportunity for rural diversification has been opened further in China by the authorization of 'township industry' — usually small — scale factories and workshops.

### III. Competition in Non-Farm Production

A penetration of market-generated transactions into the supply-determined state sector has been effected in both countries by allowing individuals to set up businesses (short of employing personnel outside the family) and production and service cooperatives. A marginal private sector had always been tolerated under the centralized system; that part which had been illicit has been legalized and is now subject to taxation. 'It is not accidental' observed Gorbachev (1987) to the Central Committee in June 'that a "shadow economy" of sorts has emerged.' The private and cooperative sector is already substantial in China and in the USSR has gained impetus from laws of 1986 and 1987 which open 29 crafts and services to private enterprise and allow cooperatives in public catering, services and the production of consumers goods. In China, the government has encouraged the general spread of non-farm individual activity, the township industries in rural areas and collective enterprises in urban areas; all help to absorb the young who cannot find state employment.

State enterprises in both countries are no longer guaranteed a supply of inputs and the purchase of outputs to the maximum of their productive capacity under an annual plan. The opening of part of their capacity to transactions negotiated by enterprises themselves is a notable relaxation of taut planning and patently introduces competition into the bulk of each country's economic activity. Autonomous management and self-financing are prominent in the Soviet 'law on the enterprise (association)' of June 1987 but they will continue to be subject to state orders (*goszakazy*) which 'guarantee the satisfaction of top-priority social requirements ...which are necessary, first of all, for the solution of state social tasks, the implementation of scientific and technical programmes, the strengthening of the country's defence potential and for the delivery of farm produce to state stocks...'. Enterprises must be assured broad independence in concluding agreements on the basis of economic norms and the orders of consumers' (Gorbachev, 1987). The corresponding Chinese law on the enterprise was on the point of enactment at the People's Congress session of April 1987 but the combination of state orders and competitive transactions has been in operation since 1979. The present writer has characterized Chinese practice as 'dual track', because each enterprise uses its capacity either under state orders or in response to market demand — from other productive enterprises or from the wholesale trade. The difference from the Soviet system, as it appears from the decisions of the June 1987 Central Committee, is that the prices at which the marketed

quantities are sold may vary from the official price applicable to state orders (Kaser, 1987). The degree of price flexibility in China varies between branch of industry. Thus by February 1987 of the production of consumer's durables and foodstuffs, 20 per cent were being sold at the official price under state orders, a further 40 per cent could be sold at a 'floating price' under state orders and the remaining 40 per cent was uncontrolled and saleable at any chosen price. The 'floating price' had to be within a range of 20 per cent above or below the official price.

Addressing the June Central Committee meeting, Gorbachev (1987) called for 'all types of prices and tariffs to be reconsidered in their aggregate and the organic connection between wholesale procurement and retail prices and tariffs should be ensured during a radical reform of the price system. It is necessary consistently to reflect in them the socially-necessary expenditure on the production and marketing of output, its consumer-oriented properties, the quality of output and effective demand.' He went on to speak of a combination of 'stability and flexibility' and the law on the enterprise, enacted just afterwards, envisages centrally-fixed, negotiated and free prices. Immediately subsequent interviews with the price authorities demonstrated the extent of price reform envisaged. The Director of the Research Institute under the USSR Committee on Prices (Goskomtsen) suggested that wholesale prices would have approximately to double, although engineering goods would not need much change, and that in retail pricing foodstuffs would increase significantly while turnover tax cuts might bring down the prices of manufactured consumers goods (Chaplanov, 1987: 1). Earlier a member of his staff, with one from Goskomtsen itself, had described the research that had been undertaken to calculate the wholesale prices that would stimulate technical innovation and diffusion (Goroberidze and Lakhov, 1986: 88-94). The Chairman of Goskomtsen spoke of existing 'prices playing little role in creating balance between supply and demand leading to continual shortages both for retail and wholesale goods' (Pavlov, 1987). He added that food subsidies in 1987 would total 58 bn rubls.

China has already experienced moderate inflation consequent upon the liberalization of pricing to competition: the official index in 1987 showed an annual rate of 6 per cent. The Soviet index, held almost constant over many years (whereas the Chinese index had been allowed to rise), will have to increase sharply as reform takes place.

The excessive Soviet retail price stability has accumulated a great deal of 'inflationary overhang'. At the June Central Committee (Gorbachev, 1987) revealed the extent of repressed inflation in the Soviet Union. He reported that between 1971 and 1985, money in circulation had increased

3.1 times, whereas the output of consumers' goods had only doubled. Retail prices for bread and many food staples have remained unchanged since 1954, while dairy products are still at prices set in 1962. A large inflationary gap opens every year, due to rises in money wages and in farm incomes, while output of goods to spend the money on rises more slowly and prices largely do not reflect the enhanced demand.

The promise of freer transactions between State enterprises, embodied in the economic reform, and the growing share of private production and trade, make essential a rational price relationship between demand and supply. The immense inflationary overhang of unspent roubles is a threat to that part of the economic reform and it was not surprising, therefore, that rumours were reported that a currency reform was in prospect. A date of next February was mentioned and the internal reform was reported to be associated with some convertibility of the external rouble.

There has been no link between the external rouble, which is merely an accounting device, the rate of exchange for which into foreign currencies is entirely formal, and the purchasing power of the domestic rouble for international transactions, whether retail or wholesale. Gorbachev's promise, however, at the same Party Central Committee meeting that the rouble would be made convertible 'stage by stage' may be linked to an internal reform so that the government may declare that the new rouble has a realistic purchasing power parity with foreign currencies and thereby render it more acceptable for Soviet citizens to hold off spending their money during the fragile period of economic reform.

A possible timetable would start, as clearly it has done, with rumours of monetary reform along the lines of those which took place in the USSR in December 1947 and January 1961. In both those past cases, 10 old roubles were exchanged for one new rouble, but in the first case, only a small holding of roubles could be exchanged and the remainder were demonetized — that is, wholly lost to the holder. The present rumour confirms that roubles in savings accounts will not incur financial loss and must be directed towards Soviet citizens who have no qualms about putting roubles into their named bank accounts. Those who have gained money illicitly, while seeking to spend their hoards between now and the date of the reform, must expect to lose any holdings that remain in each. Deposits in the savings bank will reveal to the authorities the true extent of the problem and they are likely to freeze deposits for a certain period while retail prices and the supply of consumers' goods being adjusted to the new market conditions.



#### IV. Competition from Foreign Enterprises

It would give added credibility to that new domestic rouble if some element of convertibility were applied. Initially there might be some foreign currency for travel abroad or for enterprises and shops to buy a few Western consumers' goods. Many aspects of the economic reform, including joint ventures with Western companies and freedom to trade abroad by State enterprises require a realistic exchange rate.

The relationship of domestic to foreign price relativities in the USSR has already been the subject of a decree of the Central Committee and the Council of Ministers (August 19, 1986), which defined 'differentiated exchange rate coefficients' to link 'actual contract prices' with those in domestic prices. Citing the decree and the new practice of the DVK (*differentirovaniye valyutnye koeffitsienti*) Zakharov, 1987, Head of a sub-department of the USSR Gosplan, notes that the coefficients range from 0.3 to 6.0, that is that for some transactions the domestic rouble is three times overvalued by purchasing power parity and for others it is six times undervalued. He argues that it is logical for that range to be narrowed, but that a unified single rate could not be applied until three and five years hence.

China reached that point in 1985, when a unitary exchange rate superseded the multiple 'internal settlement rates' (as World Bank termed them), but it had the advantage of 'the current account surpluses of recent years, large reserves and the ready availability of foreign capital' (World Bank, 1985:101). By contrast the USSR currently runs a large deficit in convertible currency trade, is heavily indebted to the West and would meet resistance from Western banks if it sought to raise much new money abroad.

Both China and the USSR require exchange rates which reflect comparative purchasing power if competition is to be activated from foreign enterprises. Both countries now accord substantial foreign-trading rights to domestic enterprises (though China rescinded some in 1984) and admit joint ventures with foreign firms. In addition each has a special relationship which allows wholly-owned foreign enterprises to operate on the domestic territory. For China it is the 'Special Economic Zones' along the coast near territories of which the Government expects political reunification in the future. Shantou and Shenzhen are near Hong Kong (to be incorporated in 1997), Zhuhai is near Macao (to be incorporated in 1999) and Xiamen is near Taiwan. The proximity is not irrelevant because the incorporatable territories are guaranteed their own separate economic systems



for fifty years and will constitute enclaves with numerous foreign holdings. For the USSR the special relationship is with the member states of the Council for Mutual Economic Assistance (CMEA): laws of 1987 allow firms from those countries to have wholly-owned enterprises in the USSR.

Gorbachev summarized the Party's expectations of competitiveness from abroad at the Central Committee in June: 'The reorganization of economic management opens broad scope for enhancing the efficiency of our external economic ties and — particularly important — for enhancing the impact of the external market on the functioning of industries and enterprises, on the quality of their products and on scientific and technological progress'.

### **V. Competition in Banking and Finance**

In addition to the competitiveness among enterprises arising from the motivation of state enterprises to make profits to invest and allocate themselves, common now to both countries' reforms, each is authorizing competition among banks, which will serve as adjudicator on a still-limited capital market. Enterprises can choose between ploughing-back profits and earning interest on bank deposits; China has gone further in opening modest stock exchanges in Beijing, Shanghai, Shenyang, Tianjin and Wuhan. Banks with which deposits are made are seen under the reform as competing for those deposits and for borrowers. China has already abandoned its 'monobank' system: beside the People's Bank (and the Bank of China for foreign transactions), there are now specialist banks for agriculture, investment and working capital. A resolution of the Soviet Party Central Committee, 'Main Provisions for Fundamentally Reorganizing Economic Management' in June resolved 'to consider it advisable to establish specialised banks with due account for the peculiarities of economic complexes and fuller satisfaction of the population's requirements for credit-and-settlements services, to turn the credit granting system into a highly qualified, reliable and interested partner of enterprises and organisations.'

The Soviet special relationship with CMEA has a further dimension in the sphere of banking. The resolution just cited went on to say: 'Special attention should be devoted to raising the purchasing power of the rouble, and to ensuring its stage-by-stage convertibility, first and foremost, within the framework of the Council for Mutual Economic Assistance.' Rybalko (1987), a Deputy Director of a Ministry of Finance department, foresees a role for the CMEA current-account bank, the International Bank for Economic Cooperation, in creating funds for multilateral settlements and in

establishing realistic mutual exchange rates among members.

## VI. Competition and Contradictions

A final word in this paper must relate competition with controversy and contradictions. The days are patently long past when Stalin's 'genius' or Mao's *Thoughts* over-rode all discussion. The emergence of non-antagonistic 'contradictions' was soon accepted in both countries, but the preparation and implementation of the economic reforms have raised many controversies and debates and engendered considerable differences among political and administrative groups at all levels. It is hence appropriate to conclude with the words used in a summary of a 'Round Table on Contradictions of the Socialist Economy at the Contemporary Stage' held in Moscow in November 1986. Abalkin (1987: 4): 'It is wholly natural that in the course of the discussion many interesting opinions were expounded and on many issues views were advanced which were divergent and often diametrically opposed.' It seems right to indicate that thirty years on a 'hundred flowers' are blooming in China and the USSR.

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