

Jan ■

Winiecki

RESISTANCE TO CHANGE IN THE SOVIET ECONOMIC SYSTEM

A
Property
Rights
Approach



ROUTLEDGE

Resistance to Change in the Soviet Economic System

A Property Rights Approach

Jan Winiecki



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Resistance to Change in the Soviet Economic System

Preface

A year has been a long period in Eastern Europe. Much has happened between May 1989, when this book was finished, and April 1990, the time of writing this preface.

The 'Spring of Nations' that took much of Eastern (or, more precisely, East-Central) Europe by storm was without a doubt a political phenomenon. An apparent abandonment of the doctrine of military intervention in this area under Soviet domination by the Gorbachev regime facilitated change. The Hungarian decision to dismantle border fortifications with Austria triggered a flood of East German refugees that put pressure on the Honecker regime. Once the East German communist regime fell, Czechoslovak neo-Stalinists found themselves isolated and the skilfully applied pressure by the opposition resulted in the smoothest possible transfer of power. The fall of Ceausescu completed the domino effect.

However, all these spectacular phenomena, coupled with unfolding glasnost and hiccuping perestroika, have been outcomes of the long process of decline rather than spasmodic flare-ups as they sometimes seem to outsiders. These processes have been largely economic in nature. They resulted from the distortionary, self-destructive features of the Soviet economic system and became inevitable by the resistance to change in the system. Since this book deals precisely with the subject of resistance to change, I have decided to look quickly at the impact of accelerated change in Eastern Europe on the ideas and interpretations contained in this book.

In my (undoubtedly partisan) opinion these ideas and interpretations have withstood well the acceleration of history. For years I have stressed the irreversibility of the decline. This point has been made in the book again and again. Called overoptimistic on quite a few occasions, even I did not expect, however, the demise of the Soviet economic system to happen so soon.

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I have also stressed the link between the political and economic systems in the Soviet world. The property rights approach adopted in this book is built precisely on these links. In fact, the developments since the spring of 1989 have strengthened my view that, given these links, no economic change (i.e. transition to the market system) is possible without preceding political change. Transition has begun in earnest only after the break of the communist monopoly on power. Only political change has been able to loosen the stronghold that the *nomenklatura* has over the economy. Thus it was Poland that first started the programme of the economic system's change (in spite of highly inauspicious macro-economic conditions) rather than Hungary, which began its tinkering with the Soviet economic system earlier.

The only idea that appears now to have been overtaken by events is that of softening up the resistance to change by compensation payments to bureaucrats and apparatchiks in return for their withdrawal from commanding positions and the abolition of the Soviet economic system. Put in the 'if you can't beat them, buy them out' spirit, that proposal elaborated in the last chapter of the book does not fit the new realities of East-Central Europe. Accelerated change has been taking place there without the necessity of paying the price.

I decided none the less not to eliminate Chapter 4 from the final version of the book – and for three different reasons. The first was because it is in tune with the theoretical approach taken in the whole book. Property rights theory posits that if social gains from the change in existing property rights structure are higher than the costs of re-arranging it, those who stand to lose from that change should be offered compensation, with plenty of net gain left over after the compensation.

The second reason was that the buy-out proposal – even if overtaken by events – represents none the less a certain stage of thinking about transition from the Soviet-type to the market-type economy. As such, it may well be worth remaining on record.

The third and last reason is probably the most important. Although the East-Central European societies were fortunate to have avoided the necessity of paying compensation to the ruling stratum, the Soviet Union and China (and Vietnam, etc.) have not been so fortunate. Accordingly, this way of softening the resistance to change may still maintain its topicality in countries where transition from the Soviet system to democracy and the market have barely begun.

Jan Winiecki
Warsaw, April 1990

Acknowledgements

A fair of number of colleagues, in Poland and abroad, explicitly or coincidentally, have been important in shaping the final form of arguments outlined in this book. I am most indebted, however, to Jacek Szymanderski, a sociologist of a very wide-ranging knowledge. The innumerable discussions we have had over the years on the characteristics, structure and performance of the Soviet system have been particularly helpful in writing this book. His permission to adapt one of our jointly written essays as a chapter here is warmly acknowledged as well.

My thanks go also to Assar Lindback and other colleagues from Stockholm's Institute for International Economic Studies who often invited me to the institute for discussions. It is in the excellent facilities of the IIES that various drafts of what later became Chapters 1 and 3 were finished. Their mimeographed versions in the IIES Seminar Papers series stimulated early discussion on subjects covered by this book from which I benefited handsomely.

Much of the material is based on or adapted from my previously published articles and essays. Several publishers allowed me to integrate and elaborate upon these materials in this book, for which I express my deep appreciation. Thus, an earlier version of Chapter 1 appeared in *Economic Inquiry* 1990 (forthcoming). Chapter 2 is an abbreviated and revised version of an essay written jointly with Jacek Szymanderski and published by the Centre for Research into Communist Economies (London 1989). CRCE also published another essay of mine (London 1988) upon which I based Chapter 4. An earlier version of Chapter 3 appeared in *Communist Economies*, 1989. Also, earlier versions of Chapters 1 and 2 appeared in French in *Revue d'Etudes comparatives Est-Ouest*, 1987 and 1989.

Finally I would like to thank Andrzej Mleczeko for allowing the publishers to use a cartoon published by him in an exhibition folder on the cover of this book.

Introduction

The decline of Soviet-type economies (STEs) is by now a well recognized phenomenon. Mr Gorbachev's assessment of the 'pre-crisis' state of his country's economy,¹ could in fact win the first prize in any understatement-of-the-year contest. Also increasingly well recognized is the failure of various system modifications (reforms) of the Soviet economic system undertaken to reverse the decline. At the same time, systemic change, the shift from the Soviet-type to the market-type system, is strongly resisted.

It is these latter developments that many in the West find puzzling. After all, as Mancur Olson once remarked, 'even in dictatorial systems, the dictator has an incentive to make the economy of the country he controls work better, since this will generate more tax receipts he can use as he pleases and usually also reduces dissent' (1984: 637). What is it that makes communist rulers or ruling groups different in their rejection of the way that leads to success? After all contemporary economic history knows dictatorships that successfully presided over the shift of their countries' economies from pre-capitalist, semi-feudal to thriving, capitalist market-type economies (MTEs). South Korea and Taiwan are cases in point.

Armen Alchian (1950) stressed in his celebrated article that economic arrangements (organizations, etc.) go through a process akin to natural selection in biology. Arrangements which succeed survive, while others are gradually abandoned. This approach can easily be applied to the analysis of economic systems. Other analysts approaching economic change from the similar, neo-institutional² vantage point, suggest that where high cost organizations tend to persist one should look for political constraints that block a shift to lower cost organizations. The 'new economic history' school led by Douglass North underlines the benefits from the existing arrangements, specifically the existing property rights structure, drawn by those who control the state. If a shift to a lower cost organization requires a rearrangement of the

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property rights structure detrimental to powerful elites, such shift will in all probability be abandoned, distorted or reversed under the pressure of these powerful beneficiaries of the status quo (North 1979, 1981).

The redistribution of wealth that the shift from the Soviet economic system to a market economic system entails is in my opinion the best starting point to an enquiry as to why attempts to change the Soviet economic system (or even some attempts to reform it) have failed one after another. Without analysing the property rights structure in STEs and the resultant distribution of wealth across the ruling stratum, the resistance to change looks irrational. Since there are examples of efficient dictatorships, why do communist dictators or dictatorial polit-bureaus insist on being inefficient?

The traditional analysis of the distribution of power in the Soviet system is clearly insufficient to give an answer to this question. In contrast, a property rights approach applied here by the author presents a coherent picture of the rent-seeking involved which generates support for the maintenance of the status quo. I explain that it is in the interest of some powerful segments of the ruling stratum in communist states to defend the patently inefficient economic system but the one from which they appropriate a not inconsiderable rent in ways that are incompatible with the normally functioning market system.

In the following four chapters I deal with basic issues involved in analysing sources of that resistance to change. In the first chapter I identify segments of the ruling stratum that have an obvious interest in maintaining the status quo in the economic area. I point to the fact that the existing property rights structure facilitates rent-seeking by party apparatchiks and bureaucrats through the *nomenklatura* procedure that gives them and their card-carrying cronies almost all the best paid managerial jobs, as well as privileged access to scarce goods and services. They are interested in maintaining the system as it is with respect to the state sector and they are hostile to the expansion of the private sector where such rent-seeking pursuits are either impossible (*nomenklatura*) or less easy (kickbacks).

Another important insight from Chapter 1 concerns the position of the main beneficiaries of the Soviet economic system within the existing power structure that facilitates the defence of status quo. Since the design and especially the implementation of reform or change measures is entrusted precisely to these two segments of the ruling stratum, they are uniquely positioned to abort or distort and later reverse measures that threaten to reduce or eliminate altogether the rent they appropriate from the existing arrangements.

The search for sources of resistance to change in the Soviet economic system is extended in Chapter 2 to state enterprises. I stress a differentiated position of managers and workers (in fact all other employees

than *nomenklatura* appointees) *vis-à-vis* reforms and change. Managers – part and parcel of the ruling stratum – welcome those reforms that tinker only with the existing economic system but give them greater room for manoeuvre. At the same time they are afraid of change because the game of loyalty to their superiors is usually the only one they know. More often than not they lack the qualities needed to play the game of efficiency imposed by the market system. In contrast, all workers would gain in absolute terms from the real change to a more efficient system, even if some of them were to lose in relative terms because of increased income differentials. Absolute gains may outweigh relative losses in the case of less skilled white and blue collar workers.

Having analysed the issues of who resists most strongly the shift to the market system and why, I turn in the third chapter to an associated issue of where in the economic area the resistance is the strongest. I point to the fact that although some improvements were observed in agricultural performance in STEs as a result of reforms in that sector, no such improvements have ever been registered in the case of reforms of the industrial sector.

This failure stems from a much stronger resistance of apparatchiks and bureaucrats in that sector. Industry, as shown in Chapter 3, is their prime rent-seeking area. Large enterprises in the industrial sector provide the bulk of best paid managerial jobs for the ruling stratum. Also, it is from these enterprises that many coveted scarce goods and services flow to apparatchiks and bureaucrats at below market prices. Moreover, the political clout of managers in large industrial enterprises, an obvious consequence of the close links to the apparatchiks and bureaucrats who appointed them to managerial positions, makes it much easier to obtain premiums and bonuses regardless of performance. Thus, representatives of the ruling stratum in the party and the bureaucracy on the one hand and those appointed to managerial positions on the other have vested interests in maintaining the inefficient Soviet economic system particularly in the industrial sector.

A property rights perspective enabled me to draw an unambiguous picture of links between distributional interests and resistance to the economic system's change in the Soviet-type states. Two powerful segments of the ruling stratum, party apparatchiks and bureaucrats, appropriate their rent from ruling in ways that are inextricably linked to the present economic system. Managers in enterprises are appointed through the *nomenklatura* procedure overwhelmingly from among these segments of the ruling stratum (and their card-carrying cronies). The most numerous and best paid posts are in large industrial enterprises. In consequence, changes in industry are resisted most strongly.

A property rights perspective also yields additional insights with respect to constraints on the rulers and ruling groups in Soviet-type

states. Even if they are better informed about the system's decline than other representatives of the ruling stratum, they are much more constrained in proposing remedial actions than many experts on the Soviet system expect. Every 'small but powerful group' at the top (Thalheim 1986: 40) depends to a varying but always high degree upon the support of those through whom they govern the state and manage the economy. If change of the economic system is expected to cause distributional losses to those segments of the ruling stratum who appropriate their rent from the existing economic system, the mere threat of a withdrawal of support for the rulers may be sufficient for the abandonment of change – regardless of continuing decline.

Recent spectacular political changes, particularly in Hungary and Poland, have not been accompanied by a real shift to the market system. The defenders of the status quo were able to protect their sources of rent by maintaining the *nomenklatura* procedure with its associated unequal access to goods and services. A question may be raised, however, about the longer term prospects for such '*après moi, le deluge*' attitudes of the parasitic ruling stratum.

In the fourth and last chapter, I briefly refer to my earlier considerations of the future of the Soviet economic – and political – system (Winiński 1984,³ 1986c, 1987b). I stress there that the increasingly felt inconveniences of irreversible decline may prompt those who benefit less from the patently inefficient economic system – i.e. the police and/or the military – to dismantle communist parties in order to shift to the market system (although not necessarily to the representative⁴ political system). Another probable development may be the gradual withdrawal of communists from power and associated step-by-step limitations on rent-seeking.

This author suggests in Chapter 4 that the resistance to change may be softened considerably by compensation payments in return for the withdrawal of apparatchiks and bureaucrats from their positions and the abolition of the Soviet economic system. The idea of compensation stems from the property rights approach applied throughout this book. It is based on the premise that there is a considerable net social gain left over after compensation payments if a *quid pro quo*, i.e. a shift to the market system, is achieved. However far-fetched the idea may sound to some critics,⁵ its attractiveness for apparatchiks and bureaucrats may increase over time as falling rent appropriated from the economic system and raising costs of governance will make the defence of status quo increasingly costly.

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Apparatchiks and bureaucrats: main beneficiaries of status quo

In this chapter I answer a question that is fundamental to the whole book, namely why economic reforms (to say nothing of change) fail repeatedly, in spite of the obvious interest of rulers in the Soviet system in improving their ailing economies. Approaching the problem from the property rights perspective, I stress the wealth distribution under the existing property rights structure as crucial for understanding sources of the resistance to change. A system-specific mode of rent appropriation is emphasized in this respect; one that is possible only under the present, patently inefficient economic system.

Following the age-old *cui prodest* (who gains) principle, I determine in the opening section who has the strongest incentive to maintain the Soviet economic system and why. First, incentives to prevent the emergence of market-type relations in the state sector accompanied by the well-defined property rights structure are stressed and, second, incentives to prevent the expansion of the (more efficient) private sector are explained as well. The interdependence between the marketization of the state sector and the healthy growth of the private sector are strongly underlined. Next, the strategy and tactics of aborting, distorting and reversing market-oriented reform or change by those who stand to gain most from maintaining the status quo are analysed. In the last section I evaluate the prospects of some current reforms in the light of the preceding considerations.

Who gains from status quo and why

Disincentives to change in the state sector

Most analyses of the Soviet system, including those of the economic subsystem, have centred excessively upon power distribution to the detriment of wealth distribution across the ruling stratum. In this property rights-oriented study it is rather the distribution of wealth, both

within the ruling stratum and between it and the rest of the population, that becomes the focus of attention. Power means privilege, especially in non-democratic systems, and privilege means wealth.

This shift is not intended to mean that power and its distribution do not matter. On the contrary, the rulers of a Soviet-type system may regard control over the working population through a system of hierarchical commands and fulfilment reports as satisfying their thirst for power. In other words, the satisfaction from exercising control over workers enters rulers' utility function and so does the right to dispose of the investment part of aggregate product (building 'socialist pyramids', as show-case projects are commonly called in Eastern Europe).

But it is important to realize that wealth distribution has been much more important in determining the attitudes of the ruling stratum in the case of market-oriented change. Without the wealth component it is difficult to explain why changes -- so badly needed by the rulers themselves in times of economic decline -- have failed to materialize or, if they did materialize, why they failed (or at best brought about very little improvement).

Alchian's logic of the natural selection of economic arrangements (including economic systems) referred to in the Introduction¹ suggests the following line of reasoning. Assuming that low-cost organizations tend to supersede high-cost organizations, one should first search for hidden benefits offsetting costs of an apparently inefficient system and, not finding them in this particular case, turn to the search for political constraints blocking rearrangement of a given property rights structure. Wealth increasing rearrangements may not be adopted if a new property rights structure threatens to cause distributional losses to those who control the state.²

More specifically, Douglass North's explanatory framework for the structure and enforcement of property rights and their changes over time seems to me to be most suitable for an analysis of Soviet-type states. Applying what North (1979) calls a predatory theory of pre-representative state, two basic services of such a state may be formulated:

- 1 to specify the fundamental rules of the property rights structure, i.e. to specify the ownership structure in factor and product markets that maximizes the rent to the rulers and the ruling stratum (the fact that this structure is extremely muddled in the STEs is irrelevant here, since such a muddle actually facilitates the appropriation of the rent); and
- 2 to provide a set of public goods and services designed to lower transaction costs, i.e. to increase efficiency upon which the growth of wealth is predicated (elsewhere economic growth is a synonym

of wealth but in the STEs the two are distinct, see, for example, Winiecki 1986a).

At this stage, two reservations made by North (1979) can be waived. First, North saw complications arising with the advent of a representative government. Soviet-type states clearly have a pre-representative government and, as such, can be easily analysed within the basic framework referred to above.

North (1971) also pointed out that his model – predicated upon profit-maximization – does not always hold, owing to the existence of social reformers who endeavour to devise institutional arrangements for the benefit of others. However, since we are exploring the contemporary Soviet-type states, the existence or non-existence of social reformers at the foundation of such states is irrelevant for our purpose. The ruling stratum in the Soviet-type states was rather quick in degenerating, i.e. establishing property rights in a way that maximized their rent, as described by such insiders as Trotsky (1937) and Djilas (1956). Since power tends to corrupt and absolute power corrupts absolutely, in accordance with Lord Acton's famous dictum, this is only to be expected. Thus, another of North's reservations can be waived as well.

Having said this, I hypothesize that: (i) in the Soviet-type states the fundamental conflict described by North (1979) – the conflict between efficient property rights, designed to lower transaction costs in order to increase wealth, and property rights designed to maximize rent to the ruling stratum – is strongly in evidence; and (ii) the rulers will avoid offending powerful segments of that stratum who benefit most from the status quo. Consequently, they agree to maintain a property rights structure favourable to those groups, regardless of the effects upon efficiency.

As indicated already, the system-specific mode of rent appropriation that evolved in Soviet-type states is inseparable from the structure of property rights in existence in these states. This makes any institutional change leading to lower transaction costs and increased wealth much more difficult.

To make these greater difficulties in rearranging property rights in STEs more transparent, differences with respect to the modes of wealth distribution must be clearly delineated. In the autocracies, either the old traditional oligarchies or new dictatorships based on the military and the police, members of the ruling stratum appropriate a larger share of created wealth than they would obtain under a representative government. They simply get higher salaries, more 'perks', etc., while their status symbols (articles of conspicuous consumption and/or modern professional equipment) have a priority claim upon the state budget.

The above mode of wealth distribution is not, however, the only one