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SUBJECT : Transmittal of ORR Project 14.1867,
Aspects of Selected Economic Problems
in the USSR--Productive Factors

REFERENCE : Economic Research Area, ORR Research
Support for Certain PP Requirements
dated 10 June 1957

1. The attached unclassified paper "Aspects of Selected Economic Problems--Productive Factors" is forwarded as partial fulfillment of the commitments listed in the referenced memorandum.

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Introduction

Just as Mr. Khrushchev's secret speech to the 20th Party Congress introduced a radical new element into the process of political de-Stalinization, so his current program for reforming the economic administration of the Soviet Union marks a potentially radical change in the process of economic de-Stalinization. Mr. Khrushchev's regional administration of industry explicitly recognizes that the very success of Stalin's forced draft industrialization makes it virtually impossible to continue to plan all the details of the world's second largest economy from Moscow. As the complexity and size of the economy increases there is an ever growing need to draw a sharper distinction between those decisions which pertain to detail and those decisions which determine basic policy, and having drawn the distinction, to delegate power to make decisions about detail far more widely than in Stalin's time. There is also a growing recognition among Soviet economic administrators that the measures of economic activity used in the day to day operation of the economy are too crude and have become too numerous. During most of Stalin's life there was much justification for trying to measure everything in physical units while constantly expanding the number of complex and qualitative measures of economic activity for which the plant manager must be responsible. Stalin's economic administration, like his political administration, emphasized the stick at the expense of the carrot and placed very narrow limits upon the exercise of initiative at the lower levels. The post-Stalin leadership has been reasonably consistent in attempting to encourage initiative, give it some room in which to work, and to push coercion into the background while increasing material incentives to workers, peasants, and managers.

In addition to these changes in attitude and methods of operation at the official level, there have been some faint stirrings among academic economists of the need for more economic democracy in the distribution of the economic product among various social uses. Discussions among the academic economists have centered around the functions of the various pricing systems and the consequences of pricing problems. Official circles have given little or no hint of their attitude as yet but important problems of price policy arising from the reorganization of economic administration will necessitate an official review of price systems and price policies in the near future.

The new scheme for regional administration of the economy is a remarkably bare skeleton at this point. It is intended to eliminate excessive centralization, simplify operational procedures, and encourage initiative. But there seems to have been very little thought of exactly how the new regional system is going to do these things,

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exactly what changes in procedure will take place, what will be eliminated, what combined and simplified, and so on. It is necessary, therefore, to examine the principal problems areas of economic administration which seem to be facing the USSR economy at three levels, the plant manager, the new economic council, and finally, the central planning organs. The problem areas are more or less common to all three levels of administration, but are particularly acute for the plant managers and the regional economic councils. First, there is the problem of the measures of economic activity: should the principal emphasis be placed upon maximizing the growth of output in terms of physical quantities, in value terms, or on the growth of labor productivity, or on reduction in production costs, or upon technological progress? Secondly, there is a crying need for more realistic planning: how to insure that the over-all plans are consistent with the resources -- labor, materials, capital equipment -- actually available? Thirdly, managerial initiative should be encouraged with more flexible pricing policies and more liberal distribution of profits. Finally, there is the general problem of extending the decision making authority at the lower echelons, but particularly in regard to the level of inventories, wage policies, and housing for plant workers.

The objective of this paper is to outline some specific solutions to these problems at all three levels of economic administration.

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I. The Plant Manager.

The Soviet plant manager is bedeviled by numerous criteria which his performance must satisfy. Some of these criteria are very crude, some are very complex, and in practice all are often mutually inconsistent. Unlike a capitalist manager whose primary responsibility is to make a profit, the primary obligation of the Soviet manager historically has been to fulfill the plan for output in tons (or units) of his priority product (or products). As the economy has grown in size and complexity other criteria have increased in importance. He is also expected to fulfill his plan in terms of value of production, and if he wants a bonus from higher authorities, to exceed the plan for gross value of production. Great pressure is exerted to reduce production costs, the extent to which the manager succeeds in meeting the target for cutting costs usually determining success or failure of the profits plan which in turn determines how much profits will be retained by the plant for bonuses and worker emoluments. As labor has become scarce in recent years the emphasis placed upon meeting the planned goals for labor productivity has increased. Targets for technological innovation and improved quality of product also have been added to the many goals which the manager must attempt to reach.

In addition to this welter of criteria, the manager is often the victim of certain institutional practices and mental habits of the higher authorities. The manager constantly finds that the higher authorities have revised his production plan upward with less than a proportionate increase in inputs, or they have reduced his allocations of material without an equal reduction in his output obligations. Another practice is to reduce plant inventories of scarce materials below the minimum level to cope with normal supply contingencies. To the authorities in Moscow all this represents the legitimate and necessary "mobilization of internal reserves". The managers view it somewhat differently.

The various criteria imposed upon the managers often are conflicting. It is not unusual for a product that is difficult to produce to have a lower rate of profit than one that is easier to produce. In order to fulfill the plans for cost reduction and profit the manager is tempted to overfulfill the plan for the easier product although this usually means that output of the product which is more difficult to produce will fall short of the goal. In this case the manager will be rewarded for doing well on the basis of the financial criteria but at the same time censured because the final product mix (in physical units) differed from the plan. Another source of managerial unhappiness with the present system is the wide discrepancies between the labor inputs and the prices of various commodities. Many managers feel that in a Marxist economy the prices of various products should have a close correlation with the labor inputs in the products.

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There are a number of things which could be done to simplify the criteria, remove the worst conflicts, and make the whole system of economic accounting promote more efficient use of resources. First, the overall performance of the individual plant should be evaluated primarily on the basis of a single criterion. Other measures of plant output and efficiency should be collected primarily for informational purposes. The most logical single criterion is labor productivity defined as the ratio of labor inputs to the net product of the plant. All other criteria should be subordinated to this and the plant accounting system should be reformed so that the managers and officials of the economic councils will be provided with the appropriate data.

For planning and accounting purposes output goals for the plant under such a regime would not be stated -- as at present -- in terms of gross value and in terms of a list of products in physical units, but rather solely in terms of net product, i.e., the sum of wages, amortization and profits. Labor productivity would be determined analogously to present methods, i.e., dividing net product by the number of man hours expended in production. The managers' job would be to maximize the growth of labor productivity. Growth of labor productivity would be the primary basis for planning, for judging the performance of each plant, and for paying bonuses to the managers, engineers, and technical personnel, and leading workers.

Corresponding changes in pricing policy will be necessary if prices are to reflect the socially necessary amount of labor time required to produce each product. The point of departure for setting the price of one product relative to all others should be the value of the wages paid in producing it. Thus the price of a machine tool compared to the price of a truck should be determined primarily by the relative value of the wage payments required to produce them.

The rate of profit should reflect the relative scarcity, and hence the amount of labor time that can justifiably be allocated, to the production of various products. Under the present system the central planners often decide that product A has a higher production priority than product B, and order the plant manager to produce A rather than B. As often as not, however, the profit rate on product A is lower than on product B. The managers find themselves in the unenviable position of being told to modify their production program in a manner that threatens their value of production and profit plans, and hence threatens their bonuses as well as housing and cultural amenities for the workers. And the prices of various products are a most unreliable measure of their relative scarcity. Many examples of this sort of thing appear in Soviet literature.

Apparently it is quite common place for the Ministry of Trade to request that the output of commodity X be increased in response to growing consumer demands without regard to the fact that the profit margin in the wholesale price of product X may be much lower than for

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product Y. An example of this sort of thing in heavy industry on an industry wide basis is provided by the coal industry during the last three years. It seems that beginning in 1954 the central planners discovered that they had grossly underestimated coal requirements and increased the production plans accordingly. Resource allocations, however, were not increased accordingly and the strain on the coal industry to meet the production goals was reflected in rising costs, and hence in lowered profit rates because wholesale prices were held at the same level. In 1956 when coal was in the extremely short supply the production of coal became unprofitable. Meanwhile the petroleum industry was not only exceeding production goals but was even providing a surplus for export. But the profit margin continued quite high. Obviously the price of coal relative to the price of petroleum provided no reasonable guide to the social value of the labor expended in the production of each. Furthermore, the managers in the coal industry could not be said to be working less efficiently than their brothers in the petroleum industry, considering what was being demanded of the coal industry and the inadequate resources allocated to it.

Such anomalies would be eliminated by a price system based primarily upon the value of labor inputs into production with frequent adjustment in the rate of profit to reflect the relative scarcity of various goods in the economy. This pricing policy would also eliminate the unjust burden and loss of material rewards to the managers and workers caught in the squeeze between changing priorities without corresponding changes in prices, which is so characteristic of the present system.

Another desirable change would be to make a more realistic adjustment to the fact that the cost of producing a particular product varies widely among individual plants. When setting a uniform wholesale price the central planners currently use the average cost of a number of more efficient plants whose costs are below the average cost of all plants producing the product. This is unrealistic and places an unjust burden upon the managers who operate technologically backward plants and who really cannot cut their costs to the level of the plants with new technology. Consequently, industrial profits almost invariably fall well short of the plan and a great deal of useless tension is created. Simply shifting the basis for price setting to the average cost of all plants producing the product would eliminate the problem.

In addition to these changes in pricing policy the decision making authority of the plant managers should be broadened in other respects if the managers are to be given the capability to really exercise their initiative. At present time about 90 percent of the profits are taxed into the state budget. At least 50 percent of the profits should be retained by the plant managers for financing plant expansion and for housing and other facilities for the workers. Such a policy would promote

the growth of labor productivity by increasing the effectiveness of capital investment and by stimulating the material self-interest of the workers. Capital investment would be more effective because more investment would be channelled into the most efficient plants. Furthermore, the individual plant manager usually is in a better position than the central planners to judge where a given amount of capital investment will yield the largest and most rapid return. The material self-interest of the workers will be raised when they know that half the profits will be divided between new machinery for their plant and cash bonuses, housing, clubs, creches, etc for their use. Labor productivity should grow rapidly as a result of such material incentives.

Another area in crying need of reform is the matter of inventory policy. Historically, the central authorities by means of various financial and administrative controls have kept plant inventories of key materials at extremely low levels, a few days supply at most. As a result even minor failures in the transport system or short delays in the shipment of materials from other plants produce work stoppages, which in turn cause stoppages at other plants. It's a vicious circle. Steel production is slowed by lack of coke or iron ore, machinery output falls behind schedule for lack of steel, investment projects are retarded for lack of machinery, and Pravda publishes a strong editorial against "non-rhythmic" production and irresponsibility in fulfilling contractual obligations! Meanwhile, the real culprits, the central planners who will not trust the plant managers with sufficient inventories, get on creating new problems by "exposing" some manager who has a ten days supply of steel on hand! Obviously every major plant should be permitted to hold a 30 to 60 day supply of vital materials, such as fuels, metals, timber, cement, and the like.

This leads to the final point (for the purposes of this paper) on needed changes in the status of the plant manager, namely, he should not be regarded with suspicion and should have more safeguards against arbitrary decisions by higher authority. Just as the plant manager should be trusted with larger inventories, he should be induced instead of coerced into getting the most production out of his plant. Too often the higher authority looks at the manager as one who is hiding the "internal (production) reserves" which must be "exposed" by administrative inspection and surveillance. Usually the "internal reserves" are simply insurance against failures in the supply system aggravated by inadequate inventories. Or the manager may be not making the maximum effort because of lack of adequate incentives, or the endless red tape and even suspicion involved in a simple proposal to change the plan after it has been approved. Or the manager may go to bed with production of his products going nicely and wake up to find a telegram from Moscow announcing that widgets now have the top priority and the production of widgets should cease at once! Or worse yet, in addition to his existing production obligations he is required to produce yet another product with no additional capital investment, just more materials -- likely to be delivered late -- and possibly some more workers. No wonder the managers like to keep "internal reserves" handy in the form of some unused floor space, a few unused or under-utilized machine tools, and maybe some extra workers.

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II. The Regional Economic Councils.

In order to administer the broad range of economic activity in the regions and to do it with initiative, the economic councils will require all of the decision making authority of the former ministries and more. The task of the councils will be much more complex than the ministries; instead of a limited group of products they will have to cope with the production and distribution of almost everything produced in a modern economy. And if the efficiency possible through on-the-spot decisions is to be realized, the authority needed to make the decisions must be delegated to the councils. The principal areas in which the authority of the economic councils should be very broad are: allocation of material supplies, pricing policy, and investment decisions.

The new regional system of economic administration can hardly operate effectively until the control of material allocations is taken from Gosplan and delegated to the regional councils. The regional councils must have the right to decide what the material input-output ratios ("norms") should be for the products of their region, and the decision should be made on the basis of the average inputs of material per unit of output. The present system of setting the input-output ratios on the basis of the most efficient producers is unrealistic and should be discarded. Given these decisions, the councils can then allocate the material supplies among the various producing units, and can do it more efficiently than someone sitting in Moscow. Furthermore, the councils should make the general decisions on inventory policies for the plants subordinate to them and maintain a reserve inventory of fuels, metals, etc. for unforeseen contingencies. The role of Gosplan in Moscow should be limited to coordinating material distribution and collecting information for long range material balances required for planning five to ten years in the future. Current operational decisions should be left to the economic councils.

The economic councils should have the authority to set wholesale prices for factories according to the principles set forth in the section (above) on the plant managers problems. Not only should the councils set the wholesale prices for the products produced in their region, they also should set the retail prices of consumer goods produced and sold in the area. Indeed it is in the field of establishing a close relationship between the retail and wholesale price of consumer goods that the councils face one of their most important tasks: to introduce economic democracy into the distribution of consumer goods. Under the present system a rise in demand for a particular consumer item is usually reflected first in the appearance of queues. Sometimes that is all that happens for it requires an independent administrative decision on the part

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of the retail trade organs to take cognizance of the fact that people are standing in line waiting to buy the item, and that consequently the producing organizations should be asked to step up output. However, this requires another independent decision by the producing organs, the Council of Ministers, and Gosplan, because in all likelihood increase in consumer demand was not envisaged in the original plan, and changing the plan requires a high level, coordinated, decision. The regional councils should direct the retail trade organs to increase the orders automatically for any consumer item which appears in short supply, and the producing plants to make the appropriate changes in their production plans immediately. To stimulate prompt reaction to the trade organs request for additional supplies, they should offer the producers an appropriate bonus on the wholesale price until supply of the item has increased sufficiently to satisfy demand. The producing plant would also pay a bonus for the necessary inputs. Until there is an automatic shift of resources to increase production of consumer items for which demand is rising, and until the price of these resources reflect their enhanced social value, the Soviet consumer will not enjoy the fruits of economic democracy. To give economic voting power to the consumer ruble should be one of the first priority tasks of the regional economic councils.

Just as the plants should retain half of the profits for investment, housing, and bonuses, the economic councils should retain the other half for construction of new plants and housing in the regions. The income from the turnover tax would remain centralized and would be more than sufficient (during peacetime) to pay for defense expenditures and certain long range investment projects -- e.g. the Siberian hydro-electric projects -- which cannot be financed by the economic council resources alone. This financial arrangement would promote more efficient use of investment resources, and hence stimulate the growth of labor productivity. The economic councils also would have a direct stake in the efficient operation of their subordinate plants.

III. The Central Planning Organs.

The most important thing the central planning organs and the Council of Ministers in Moscow can contribute to the success of the regional administration of industry is a change of attitude. Moscow must learn to coordinate and assist rather than coerce. Moscow must delegate to the regional economic councils and to the plant managers the authority to make decisions concerning the disposition of economic resources. Hitherto the lower echelons have borne most of the responsibility for the production program while the central authorities disposed of the resources. Moscow must cease to make unreasonable demands for production beyond the capacity of the plants' on the specious grounds of "mobilizing internal reserves". It was precisely this kind of "planning" on the part of the center that led to the current revision of the Sixth Five-Year Plan and to the extreme shortage of fuels, metals, and building materials currently plaguing the Soviet economy.

Other broad changes in planning policies should be studied by the central planners. It has been obvious for many years that the planners working on investment projects needed some guide to the choice of alternatives. Over the years a number of Soviet economists have proposed a reasonable solution in the form of a "coefficient of effectiveness", i.e. a rate of return over time on the initial investment as a guide to choosing investment alternative. So far these proposals have all been rejected, principally on the basis of ill-founded ideological arguments that the coefficients were too similar to capitalist interest. At the same time it does appear that the use of "coefficients of effectiveness" has been tolerated in practice in many project planning organizations. Just as it has been officially recognized since Stalin's death that technological obsolescence exists under Soviet socialism as well as under capitalism, so it should be recognized that rational investment planning is impossible without a uniform guide in the form of a rate of return over time to investment choices. Working out a uniform investment choice criteria for industry, transport, and agriculture should be one of the most urgent tasks of the USSR Gosplan.

Consideration also should be given at the highest level to the problem of bringing consumer goods and producer goods prices into a relationship that corresponds to their respective social values. In recent months a great many Soviet economists have admitted that the prices of consumer goods are well above their social value -- principally because of the turnover tax which often accounts for 70-80 percent of the retail price -- while the prices of producers goods are well under their real social value. It is clear that retail prices should be lowered while the wholesale prices of producer goods should be increased. But how much to lower the

one and raise the other is virtually impossible to determine under present Soviet pricing policies. The only way the central authorities can arrive at a reasonable approximation of the relative changes required is to give the consumer ruble an economic vote as suggested above. If an increase in consumer demand is allowed to automatically call forth an increase in output and if the increase in output of the item is accompanied by higher prices for the capital material and labor required to produce it, then the central planners will be in a position to measure the relative social value of producer and consumer goods.

In general, the success of the new system on economic administration depends upon two things. First the plant managers and economic councils must be delegated broad decision making powers commensurate with their responsibilities. Secondly, economic democracy must be introduced by giving consumer purchasing power a direct and immediate vote in the allocation of economic resources.