THE LIBERMAN PROPOSALS AND THEIR IMPACT ON THE DEVELOPMENT OF SOVIET ECONOMIC THOUGHT

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THE LIBERMAN PROPOSALS AND THEIR IMPACT ON THE DEVELOPMENT OF SOVIET ECONOMIC THOUGHT

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ii

PREFACE

The proposals of E. G. Liberman suggest a reform of the Soviet economic administration which would allow a more effective use of the country's economic resources. His suggestions call for improvements in planning efficiency and operating incentives with more emphasis on profitability as the key success indicator for evaluating enterprise performance. These proposals generated a great volume of controversy in Soviet economic thought and brought into the open frank consideration of the problems of capital allocation, profits, and the Soviet system of pricing and material-allotments. The purpose of this thesis is to investigate Liberman's proposals critically and to assess their impact on Soviet economic thought.

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TABLE OF CONTENTS

LIST OF TABLES

CHAPTER I

INTRODUCTION

Problem

The Soviet economy is essentially a planned economy of command. At the 22nd Congress of the Communist Party of the Soviet Union in October, 1961, a New Party Program was adopted which stated fundamental propositions to be used in assessing established planning practice: (1) "The economic independence and the rights of local organs and enterprises will continue to expand within the framework of the single national economic plan. Plans and recommendations made at lower levels, beginning with enterprises must play an increasing role in planning." (2) "The entire system of planning and assessing the work of central and local organizations, enterprises and collective farms, must stimulate their interest in higher targets and in the maximum dissemination of advanced production experience."[1] This "official" concern of the new party program with the role of the enterprise in planning and the incentive system under which the firm operates led Evsei Grigorievich Liberman*

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[1] E. G. Liberman, "Planning Production and Standards of Long-Term Operation," Problems of Economics, "English translation of the U.S.S.R. monthly journal, Voprosy ekonomiki." (New York, International Arts and Sciences Press, Vol. V, #8, December, 1962), p. 16.

*Evsei Grigorievich Liberman is Chairman of the Department of Political Economy of the Kharkov Institute of Technology.

to summarize the problems of planning on the enterprise level. As an introduction to his proposals, Liberman stated that "present procedure of planning the work of enterprises stifles their initiative, does not permit the maximum utilization of production potentialities and the advantages of the new system of management, and does not make enterprises interested in further raising the efficiency of production."[2] Briefly, the problem to which the Liberman proposals are addressed is the inefficiency experienced at the firm level under the Soviet system of planning.

Purpose

The Liberman proposals suggest a modification of the relationship between the enterprise and the planning process to reduce the existing inefficiency in the operation of the enterprise. On September 9, 1962, his proposals were published in Pravda and were exposed to western readers for the first time on a widespread basis.[3] The subsequent attention they received generated support, criticism, and modification. This controversy raises the question: Have the Liberman proposals had any effect on Soviet economic thought? The purpose of this thesis is to investigate these proposals critically, to assess their impact on Soviet economic thought, and to evaluate the hypothesis that these proposals have had a positive effect on the development of contemporary Soviet thought relative to rationality in planning.

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[2]Liberman, p. 16.

[3]Alec Nove, "The Liberman Proposals," Survey, (London, April, 1963), p. 112.

Procedure

A descriptive and historical background of the Soviet system and its problems is presented in Chapter II to supply an overview of the system with which the Liberman proposals are concerned. This background begins with an exhaustive description of the economy and the social framework within which the economy operates in order to consider planning in its proper perspective. The historical evolution of the Soviet system is also discussed here to provide a point of reference from which planning structure and the mechanics of plan formulation are considered prior to a discussion of planning, per se, and its inherent problems. Planning is then discussed in terms of the goals toward which the plan is aimed and the success indicators by which achievements are evaluated. The role of rationality in Soviet planning is then considered. The performance of the Soviet economy is briefly viewed in terms of its implications as to the development of Soviet economic thought.

After developing this institutional and historical background, the Liberman proposals are introduced in Chapter III with a brief summary of their evoluation from their inception in 1955 to their publication in Pravda in 1962. Next the examination of these proposals is divided into two parts. The relationship between the enterprise and the planning authority relative to instructions, indicators, and autonomy of action is discussed in the first part. In the second part, the use of incentives to achieve efficient production are considered.

In Chapter IV, the proposals are evaluated with respect to the different opinions and criticisms they generated. This evaluation is divided into three parts which reflect the different categories of literature surrounding the Liberman proposals. The first category consists of opinions which were against the proposals for economic or ideological reasons; the second entails a consideration of the "moderates" who attempted to modify the proposals; the third category deals with the endorsements of the proposals.

Chapter V is divided into two parts. The first part presents a summary of the evaluations and the subsequent conclusions relative to the hypothesis of this thesis: The Liberman proposals have had a positive effect on the development of contemporary Soviet thought relative to rationality in planning. The second part centers on the implications of the Liberman proposals for the future and suggests areas for further study.

Limitations

There are two principal limitations to the scope of this study. The most obvious limitation is the fact that much of the literature and opinion which emerges in the Soviet Union is not translated into western journals or is not available in print at all. The other major limitation is that the suggestions contained in the Liberman proposals have not been applied to the Soviet economy in practice on a large-scale basis, and consequently, they cannot be evaluated as practically and objectively as one might desire.

CHAPTER II

THE SOVIET-TYPE ECONOMY

The Less-Than Command Economy

The description of any particular economy requires qualifications and restrictions to delineate it explicitly from the general models employed theoretically but seldom encountered in pure form in reality. In all economic systems, the basic problem is the allocation of scarce means among competing ends for the achievement of maximum results.[1] The solution of this basic problem defines the functions of an economy and the method by which these functions are performed. The basis function of an economy is to forge and maintain the bonds which guarantee the material survival of society by performing two related tasks:

1. Organization of a system for producing goods and services.
2. Establishment of a system of distribution of the fruits of production among its own members.[2]

George Halm expands these general tasks into a more precise listing of seven functions which must be performed by any economy, independently of the socio-economic system that might be chosen. These seven functions are:

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[1] George N. Halm, Economic Systems, (New York, 1960), p. 11.

[2] Robert L. Heilbroner, The Making of Economic Society, (Englewood Cliffs, New Jersey, 1962), pp. 4-5.

1. Deciding what is going to be produced.
2. Deciding how to produce the commodities on whose production we have decided.
3. Setting aside part of the productive resources for capital goods production.
4. Solving problems (1) through (3) so that all the interdependent production processes are properly balanced.
5. Ensuring "full" use of the available resources, particularly of the labor supply.
6. Distributing the total product of the social economy.
7. Motivating the human element in the productive process to do the right things at the right time.[3]

Economies run by tradition, command, and the market are the general types of systems by which these economic tasks are performed. The Russian economy incorporates command, tradition, and the market in varying degrees, but may be classified as a command economy; however, it is a less-than-absolute-command economy. A command economy, as defined by Gregory Grossman, is an economy in which the individual firms produce and employ resources primarily by virtue of specific directives (commands, targets) from some higher authorities; thus, in a command economy, the firms have little autonomy, and the system as a whole is relatively little decentralized, or relatively centralized, compared to a market economy.[4] Grossman, taking into consideration the

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[3]Halm,, pp. 13-14.

[4]Gregory Grossman, "Notes for a Theory of the Command Economy," Comparative Economic Systems, ed. Morris Bornstein, (Homewood, Illinois, 1965), p. 139.

autonomy of the firm and the degree of centralization involved, defines a less-than-absolute-command economy as an economy in which basic decisions regarding the allocation of resources are made by the central planners who respond to broad policy goals laid down by the political leadership, but who formulate their directives on the basis of information supplied by subordinate operational and supervisory organs.[5] The Soviet economy in practice conforms more closely to Grossman's less-than-absolute-command economy than it does to an absolute command economy in that Soviet firms have some degree of autonomy in their actions and every detail of economic activity is not decided by the planning authority.

In addition to the characteristics of a less-than-absolute-command economy, a description of the workings of the Russian economy must include as a framework a picture of the socialist society through which it operates. In a general sense, a socialist society is characterized by an institutional pattern in which the control over means of production and over production itself is vested in a central authority.[6] This central authority may be informed of the interests of society arbitrarily by a "Party-Priesthood" or democratically by vote, or by any combination between these two extremes. The various compromises between these two extremes encountered in the actual operation of socialist economies give rise to "mixed" socialism in which both public and private spheres of influence operate. Somehow a mixture of the state preference function

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[5] Ibid., p. 140.

[6] Joseph A. Schumpeter, Capitalism, Socialism and Democracy, (New York, 1950), p. 167.

and the system of individual preference functions must be achieved on the basis of a dual valuation system.[7] Halm states that "in practice all economic systems are 'mixed' in the sense that the predominantly free systems contain elements of planning and that the planned systems make use of monetary incentives and of monetary accounting procedures. However, economic literature discusses under the name of mixed systems specifically economies (real or potential) which combine the features of free consumers' and occupational choices with government ownership of, at least, the 'strategic' industries, and a fair amount of central planning."[8] The degree to which freedom and autonomy of production are mixed with social ownership and centralization of authority subdivides socialism into more specialized categories. The Russian form of socialism is a special category.

Although it is grounded in traditional Marxist theory, present Russian socialism may be described as "mixed" in that all means of production are not owned or controlled by the State. There are areas of the economy in which private ownership and autonomy of activity occur, and this removes to some degree the Soviet practice from "pure" socialism. Alec Nove divided the Soviet economy into the following spheres: state enterprises, non-agricultural co-operative enterprises, collective farms, and private sector.[9] The private sector is composed

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[7]Jan Drewnowski, "The Economic Theory of Socialism: A Suggestion for Reconsideration," Comparative Economic Systems, ed. Morris Bornstein, (Homewood, Illinois, 1965) pp. 123-124.

[8]Halm, p. 21.

[9]Alec Nove, The Soviet Economy, (New York, 1965), p. 27.

of small agricultural holdings, crafts, services, the arts, and small shops; but the largest private sector is the Russian labour force itself. Free occupational choice exists generally and labour is allocated in response to money wage differentials determined by the State for incentive and allocation purposes. The existence of this private sector in the Soviet system is one example of the "mixed" nature of Russian socialism and the less-than-absolute-command economy. However, even within the state-owned sector, control of resources is not absolute. Despite the fact that resource allocation is subject to arbitrary central decisions and some fifteen hundred materials are classified as critical and are allocated closely, some of the less critical items are not scrutinized so closely.[10]

Another manifestation of the "mixed" nature of the Russian system is the existence of some freedom and autonomy of action on the part of plant managers in Soviet industry. A state enterprise definitionally belongs to the state, but the state does not direct every detail of the economic activity of the enterprise. Nove refers to this mixture of state and individual control as a complex interaction between the planner-administrators on the one hand, and the productive enterprises on the other.[12] The enterprise director or manager shares to some degree the decision making authority of the planners; the application for a material allocation by a plant manager has some influence upon the process of distributing the commodity in question even with a

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[10]Robert W. Campbell, Soviet Economic Power, (Boston, 2nd ed., 1966), p. 45.

[11]Nove, p. 39.

system of highly centralized supply. The manager also maintains the profit and loss accounts of the enterprise with almost complete autonomy in the use of the enterprise fund. These autonomous activities on the part of the plant managers indicate something less than complete state control of the individual enterprise.

And finally, the distribution of the product of the economy is achieved by a mixture of state and private functions. The distribution of intermediate products among different industries for further production is exclusively within the realm of state control; however, some products and resources, not defined as critical by the state, are transferred between the various firms of an industry by the individual plant managers. And, in the consumer sector, distribution of the final product is privately controlled by the mechanism of consumer demand, but the composition and quantity of this final product are determined by the state. In short, consumers are free to spend or save their money incomes as they wish on goods supplied by the state in quantities fixed by the state.

Describing the Russian economy in terms of a "mixed" socialist society characterized by command does not complete the description. The final facet is planning. Planning is the means of subjecting the economy of a nation to the direction of conscious human will. Economic planning is an essential feature of socialism, and Russian socialism is no exception. Russia, as a socialist society, is definitely committed to planning to achieve predetermined goals. However, before discussing planning as the method by which these goals are achieved, a brief review of these economic goals is presented.

The Goals of the Soviet Union

This thesis will not deal with such ideological goals as the "withering away of the State," establishment of the pure Communist State, etc., but rather with the primary task of the Soviet economy which is the establishment and perpetuation of a Russian Socialist State.[12] It was not completely clear to the Bolshevik leaders immediately after the October Revolution of 1917 that their survival depended on large-scale industrialization, but by the middle twenties, there was general agreement that the successful maintenance of the Soviet State required industrialization and economic growth.[13] And since the establishment of this basic goal in the 1920's, the Party leadership has been virtually obsessed with achieving rapid industrialization and economic growth.

Given the backward condition of both agriculture and industry in Russia in the early years of the Communist regime, the Party leadership's obsession with rapid growth and industrialization necessitated at least two secondary goals of a complementary nature. Growth and industrialization implied increased agricultural production as a prerequisite for industrialization or military expansion, and this increased agricultural production was attained through collectivization of agriculture. This collectivization of agriculture and the subsequent sacrifices imposed on the peasantry in turn called for the second requisite of highly centralized control of the economy. Having achieved

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[12] Oskar Lange, "The Role of Planning in Socialist Economy," Comparative Economic Systems, ed. Morris Bornstein, (Homewood, Illinois, 1965), p. 199.

[13] Campbell, p. 12.

the collectivization of agriculture and the solidification of economic control under a dictatorship, the Soviet economy moved toward the fulfillment of its basic objective. Campbell describes the Soviet economy as a totalitarianism harnessed to the task of rapid industrialization and economic growth.[14] This basic goal of rapid growth has been institutionalized in the slogan "to overtake and surpass the capitalistic countries" and has become a generally accepted part of the Russian economic environment.[15]

With this description of the basic goals of the Soviet economy, planning as the method of achieving these goals is considered. But a consideration of plans and goals and their achievement must begin with an understanding of the structure of planning.

The Planning Hierarchy

The Soviet planning structure is designed to attain an optimum level of information transfer from the lowest to the highest organic unit and to use this information to formulate, as well as to adjust the plans. Since all industries, sectors, and regions have indigenous peculiarities, the planning structure is not rigidly restricted to any constant form, and there are many variations within the lower elements of the organizations. With this qualification in mind, a general description of the planning hierarchy is possible.[16]

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[14]Campbell, p. 8.

[15]Ibid., p. 26.

[16]See Appendix.

At the apex of the planning pyramid is the USSR Government, - for all practical purposes, the Central Executive Committee of the Communist Party. In March, 1963, a new supreme central organ was created: The Supreme Council of National Economy. This council operates as liaison between the actual planning organizations and the Party; it coordinates the coordinators. The first economic organ is actually a dual body which replaced the Council of Ministers in the planning reform of 1957, and is composed of the Gosplan and the USSR Sovnarkhoz.* [17] This division of the central planning authority is based on function, with the Gosplan formulating long-term plans and the USSR Sovnarkhoz implementing the short-term plan. The planning reform of 1957 changed the structural emphasis from ministerial divisions to regional or territorial groupings, and in 1961 this was strengthened by the formation of eighteen "big planning regions" which were to aid Gosplan in constructing long-term plans extending beyond the limits of regional divisions.[18] Immediately under these super-regions** are are the Republican Governments, (Republic of the Ukraine, Republic of Georgia, Republic of Belorussia, etc.) These republican governments contain a Republican Gosplan which duplicates for the regional economy the role performed by Gosplan at the national level. The Republican Gosplan drafts its own plan to include all industrial activity in its region, allocates most of the materials within the republic,** controls

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*Sovnarkhoz: economic council (plural: Sovnarkhozy).

[17]Nove, p. 67.

[18]Ibid., p. 79.

**Italics mine.

***Allocation of critical materials is controlled by Gosplan.

local industry through the oblasti,* and supervises its sovnarkhozy (regional economic councils). The regional sovnarkhozy parallel the function of the USSR Sovnarkhoz on a smaller scale by implementing the regional plan. This implementation entails actual detailed control of the enterprise by appointing and dismissing enterprise managers, supervising the fulfillment of the plan, and encouraging new techniques and specialization. In addition to control of the enterprise, the regional sovnarkhozy also initiate the first step of the planning process by constructing proposed plans for each enterprise and forwarding them to the republic Gosplans for perusal and aggregation. Beneath the regional sovnarkhoz level, industry is divided into sector departments to facilitate gathering information from similar enterprises from which to draw the proposed plan. And finally, the sector departments consist of the various individual enterprises.[19]

This description of the vertical structure of the planning organization is not complete without reference to the control hierarchy which parallels the formal planning structure at every level. For the sake of brevity, the mechanisms of control will be mentioned en passant. Corresponding to every level of planning organization, there is a horizontal relationship with an equivalent Party organ which acts as a check and balance on the actions of the planning unit. And in addition to the Party, there is the added control of the financial institutions and statistical agencies which control the accounting of all financial

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*Oblast: local industry council or administrative group. (Plural: oblasti).

[19]Ibid., pp. 67-81.

transfers and transactions and the compilation of all operational data respectively.

The Mechanics of Plan Formulation

In outlining the planning structure and the functions of the various units, from the central organ of the Communist Party to the individual firm, reference was made to plans and to proposed plans. A clarification of these terms necessitates a brief resume of the creation of a plan. The procedure by which a plan is created was implied in defining the functions of the different planning organizations, but the explicit process of planning has its origins at both extremes of the chain-of-command.

The Party priesthood, divine interpreters of the Communist ideology, from the commanding heights of the Central Executive Committee decide the long-range objectives of policy or goals for the entire economy; but far removed from the titanomachy of the Kremlin, a plant manager in the Ural Mountains submits the operational data of his firm to the sector department to which his plant has been assigned. The mechanism by which these two entities are united is the plan. Detailed information about current plan fulfillment, inputs used, and outputs obtained is forwarded from the enterprise to the sector department, and then to the regional sovnarkhozy. The regional sovnarkhozy incorporate all the information they receive into a regional plan which is sent to the Republican Gosplan for amalgamation and coordination with plans of the other regional sovnarkhozy. The information is passed through the entire hierarchy with additional revision and aggregation at each ensuing

level until it reaches Gosplan. At this point in its development, the plan is a proposed plan and has not been approved for actual implementation. The Gosplan combines Party directives translated to it by the Supreme Council of National Economy with the proposed plans based on aggregated operational information received from the Republic Governments and by making projections attempts to reconcile Party objectives and actual capacity in a Seven Year Plan. Now, having established the targets with a long range plan, the implementation of these targets is planned by the USSR Sovnarkhoz in the form of one year plans, with targets or quotas usually divided into quarters. These short term plans are then transmitted back down the chain of organizations and precipitate a period of further information transfer and pseudo-arbitration. And after revision and resubmission, the plan is approved by the Gosplan. But approval and ratification do not render the plans final in the strictest sense of the word; because even during the course of operation the plans are revised and changed by directives to compensate for unforseen contigencies, either operational or ideological.

So we find the targets of the economy outlined in the formulation of the long-run plan (three to seven years), but achieved and evaluated in the fulfillment of the short-run plan (one year or less).[20] And it is here, in the area of actual implementation and subsequent evaluation of the plan that the problems associated with planning arise. Since plans are drafted to achieve targets and goals, an evaluation of the success achieved by the plan relative to these targets and goals

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[20]Stanislaw Wellisz, The Economies of the Soviet Bloc, (New York, 1964), pp. 99-100.

must be attempted. For such an evaluation, the Soviet system uses a variety of success indicators.

The Success Indicators

The Soviet system uses many success indicators to evaluate the different aspects of plant operation in meeting the targets prescribed by the plan. The primary objective of the enterprise is to fulfill or over-fulfill the output target stated in the plan; consequently, plan fulfillment is one of the most important indicators. But in addition to plan fulfillment, other indicators such as labour productivity, cost reduction, economy of scarce materials, wage funds, innovation, and profits may be used.

As these various indicators are discussed separately in terms of their respective advantages and disadvantages, it becomes obvious that in toto, the indicators are not mutually inclusive and are, in fact, contradictory in some degree. Complying with the multi-target indicators under the constraints and shortages associated with his particular circumstance becomes the essence of the manager's quandry.

Soviet planners consider plan fulfillment in physical terms the most obvious success indicator, so whether at the enterprise, sector, or regional level, the primary task of the director is to fulfill, and if possible, to over-fulfill the output plan. This output target which the manager attempts to fulfill is expressed in some kind of physical measure or when physical measure is impossible, then in value (rubles of gross output). It is this concept of physical measure which presents one of the problems in the evaluation of plan fulfillment as a success indicator.

Grossman refers to this problem of physical measure as one of definition or grossness.[21] The crux of this problem lies in the fact that the target for the firm is stated in terms of gross product rather than net contribution to the national product. An example of the difficulty associated with the use of physical measure is the tendency of the individual managers to choose production processes which are material-intensive to facilitate meeting their target quotas. Despite the fact that products may have more than one physical dimension, the intrepid managers will arrange their production to favor that measure chosen by the plan in an attempt to meet their quotas easier. The following example is revealing of the practices of managers to adjust their production process to the measure in which the plan target is stated.

If, for instance, roofing material is measured in tons rather than square meters, the manager will make his roofing material as heavy as possible. Conversely, if the unit of measure is square meters rather than tons, the manager will have the roofing material rolled as thinly as possible so as to produce the greatest surface area. And even if the plan expressed output targets in ruble value rather than physical measures, the manager simply chooses the most expensive material inputs possible with which to fabricate the roofing material with little regard to quantity produced. A humorous example of the problem of grossness appeared in the journal Krokodil as a cartoon.[22] The cartoon showed a factory which had fulfilled its entire month's

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[21] Grossman, p. 144.

[22] Nove, pp. 163-64.

output program for nails by manufacturing one gigantic nail, and the nail was so large it filled the whole length of the workshop.

Another problem arising from the use of physical measures is the fact that quotas are often interpreted to include unfinished work at the end of a plan period as part of the gross output. The result is that there is often an enormous amount of in-process material at the end of the plan period. Within the industries producing intermediate goods for further production another phenomenon of grossness occurred. Production is set to the largest tolerance so the intermediate product will have the greatest gross weight. An example of this problem is found in tool casting industries. In this case, the directors of the foundries manage to have the castings poured so that the greatest amount of slag and roughage is left on the casting. Subsequently, the gross output target expressed in weight is achieved with fewer castings. In the next production process of machining the casting, the excess material which must be tooled away not only constitutes a waste, but the extra time and energy expended by the machinist is wasted as well.

In addition to the waste involved in the managers' preference for material-intensive products induced by the use of quotas expressed in physical terms, another problem having to do with the composition of the aggregate is often observed. When targets are set in terms of gross output, no matter how detailed the plan may be, there is usually some aggregation of sub-commodities, with the composition of the mix left to the discretion of the individual managers. In these cases, the managers determine the proportions of the sub-commodities within the aggregate on the basis of their own convenience and particular

circumstance with little consideration being given to the later users of the product. An example of this difficulty is found in the production of screws and nails in which production decisions as to size and type are more compatible with plan fulfillment in the aggregate than with the needs of the consuming sector. This results in imbalance among the sub-commodities of an aggregate even though the aggregate may meet with the target prescribed by the plan. Shortages and surpluses of some sub-commodities are the obvious result.

Measure of targets in physical units is not the only problem associated with the use of plan fulfillment as a success indicator. The integrity of the individual plant managers may be affected by the fact that meeting or even exceeding the quota determines their bonus for the plan period. As this discussion has already indicated, the manager helps make the plan by submitting his production data and expected future requirements to his superiors in the sector department to which his plant is subordinated. Nove describes the result as a penalty for honesty and a reward for deceit in that an understatement of capacity and potential by the managers in constructing their part of theiplan often leads to their receiving a less demanding plan than the managers who report their data honestly.[23] In effect, managers try to construct a plan which will be easy to fulfill or even over-fulfill. This tendency is sometimes carried over to the intermediate levels of the planning organ. A regional or republican planning authority may be just as interested in being able to report an over-fulfilled plan as is

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[23]Ibid., p. 162.

the individual manager, and consequently, tolerate understatement of potentials and hidden capacity via the manager reports.

But the integrity of the managers is not the only thing affected by plan fulfillment as a success indicator. Another problem arises in the influence of the calendar on economic activity. Plan fulfillment and target dates have produced a phenomenon in Soviet industry adequately described by the word "storming."[24] This practice is typified by a last minute, mad rush to complete the plan in the last days of the allotted time, followed by a disorganized period of slack production after the target is met. This practice may not be necessarily unique to a planned economy, but may have its origins in a natural human bent to procrastination, or the traditional peasant orientation to short frenzied growing seasons followed by lazy winter months of inactivity; but regardless of its origin or the fact that this problem may be found in capitalist economies, it nevertheless exists in the Soviet economy and should be considered as a problem of the system.

Labour productivity as an indicator is related to the problems associated with the grossness of physical measure. Changes in labour productivity are subject to distortion when computed relative to the gross output figures where these figures are determined by the most material-intensive combinations available. The roofing material example previously cited will be useful in expanding this statement. If a factory with a labour force of fifty workers produced fifty tons of roofing material which was highly material-intensive, then productivity per worker

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[24]Ibid., p. 167.

measured in terms of gross output would be greater than labour productivity of fifty workers in a similar plant which had produced the same surface area of roofing material, but with lighter materials having a gross weight of twenty-five tons. Thus, plant managers find that they can increase labour productivity relative to gross output by producing a material-intensive gross output. But the labour productivity indicator, in such a case, is contradictory to other success indicators such as a cost of production indicator or one expressed in terms of materials.

The plant manager is often faced with the decision of satisfying his gross output target by using material-intensive production methods and sacrificing cost of production and economy of materials, or of reducing his costs of production and economizing on inputs at the expense of a high score re such indicators as gross output. However, emphasis on cost of production and economy of materials carries with it the danger of deterring quality improvements in the product and discouraging innovation. Attention to these two indicators by the managers usually results in low quality outputs and in some cases even appreciable alteration of the design of the product itself. But, the emphasis of the individual managers will reflect the particular revealed preferences of his planning superiors, and the manager will be sure to give primary attention to those indicators which are rated higher by his superiors than those which are considered marginal. Furthermore, of all the Soviet success indicators, profit is the least important to the planners and consequently to the managers.

Profit as an indicator is given positive consideration if it is incidental to a reduction of the cost of production target, but does not

carry the negative connotations associated with losses in that many planned targets openly necessitate a loss. These planned losses are mainly the result of prices fixed to barely cover average costs of the industry. If prices cover the costs of the average firm, then those firms with costs above this average face an unavoidable loss and firms with costs below the average appreciate a profit. Such planned losses are not considered a failure by the planning authority, but failure to meet the output quota would not be viewed with equal disinterest.

This negative presentation of the success indicator system should not be interpreted to imply that Soviet industry is rendered wasteful, inefficient, and nearly paralyzed by this mechanism. These problems are listed to point out the degree to which these indicators represent the absence of economic rationality. Economic rationality in a Soviet-type system implies the most efficient use of resources to achieve the politically determined ends. Prybyla strips this concept of political prejudice and dogmatic emotionalism by stating that economic rationality is not a question of the rationality of the preferences, but rather, of the most rational manner of expressing such preferences and the most efficient way of achieving them. This is an admonition to the student of systems not to color his considerations with the moral and ethical implications of the goals of any system he studies, but to apply the elements of economic theory to the system and its methods of achieving its goals whether these goals conform to his own value judgements or not. So with this admonition in mind, rational planning is considered.

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[25] Jan S. Prybyla, "The Quest for Economic Rationality in the Soviet Bloc," Social Research, (Vol. 30, Sept. 1963), p. 16.

Rational planning has two main aspects: coordination and efficiency. Coordination ensures internal consistency and balance among the actions of producers and consumers; and efficiency requires that producers follow courses of action which use the smallest possible input of resources to obtain the required output.[26] However, before applying the two concepts of coordination and efficiency to Soviet planning, a brief development of the role of rationality in Soviet planning will be presented.

The Background of Rationality in Soviet Planning

When the Bolsheviks gained control of Russia in the Revolution of 1917, they attempted an immediate application of Socialism and central planning to a system previously characterized by a free market economy. The ensuing period, referred to as "war communism," was marked by economic chaos and failure. "War Communism" constituted an attempt, which proved premature, to realize the Party's stated ideological goals of a pure socialist state principally through two measures: (1) Requisition of grain from the agricultural sector and (2) nationalization of all major industries without compensation.[27] The result of this policy was embittered resistance on the part of the peasantry and inability of the workers to operate the nationalized factories in the absence of their former owners and managers. During this period of "war communism" in the spring and summer of 1918, economic directives issued from the central organs of the Party exemplified the Jocobin tradition which

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[26]Campbell, p. 83.

[27]Donald W. Treadgold, Twentieth Century Russia, (Chicago, 2nd ed., 1966), pp. 164-65.

brought the Bolsheviks to power: the end justifies the means. The implication of this attitude of Party leaders to the economy indicated an almost total absence of rationality in planning and contributed to the almost complete suspension of economic activity. But other forces played a part in weakening the Russian economy at this point, for with their revolution, the Bolsheviks had not inherited a strong, well ordered economy. Russia's participation in World War I under the inept autocracy of Czar Nicholas II had almost completely destroyed public faith in the autocracy and the central bureaucracy. The economy was severely strained to meet the military requirements of a modern war vis-a-vis with an industrial entity of the magnitude of the Austro-German coalition. The intervening period between the February and October Revolutions is referred to as the Duma or Provisional Government period (March 15 to November 7, 1917).[28] This brief attempt at constituent control brought the deadly combination of inactivity linked with inability; so when the Bolsheviks assumed leadership on November 8, 1917, very few courses of action they could have initiated could have made things any worse.[29] But they did manage to intensify the economic confusion by the implementation of "war communism." The Civil War following the revolution and the desperate effort of the Bolsheviks to maintain their control compounded the detrimental economic effects of the "war communism" period.

The retreat from "war communism" into the New Economic Policy (NEP) re-established the mechanism of the market as an element of economic

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[28]Ibid., pp. 126, 149.

[29]Ibid., p. 149.

policy by allowing a partial restoration of a free trade for the peasants and small-scale enterprises. The private sector of the economy was reconstituted with the State maintaining the "commanding heights" of industry. With this approach, the recovery of the economy rapidly approached pre-war levels of production. This compromise with capitalism, although rationalized by Lenin as a temporary necessity to save the economy, was interpreted by some party leaders as a betrayal of the revolutionary ideology, and this dissention within the Party gave rise to the Great Industrialization Debate.[30] The resolution of this debate was to have a profound effect on the future role of rationality in Soviet planning. The outcome of this contest was obvious with the solidification of party power by Joseph Stalin in 1928, and the adoption of the first Five Year Plan in 1929. The future of rationality in the Soviet system is summarized in Nove's statement, that given the nature of the regime, of the economic tasks to be achieved, the hostility of the ideology to any talk of economic rationality, the net effect was to keep in being forms of economic organization designed to achieve rapid results in priority sectors by quantitative direction.[31] This conscious direction of economic activity by the planners to priority sectors of the economy raises the question of balancing and coordination.

Coordination and Balancing

The complex inter-relationships between economic magnitudes constitute the essence of the balancing problem, and the solution has been

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[30]Campbell, p. 12.

[31]Nove, p. 155.

sought in using material balances relative to input-output relationships. Coordination in any economy requires adequate information to understand the issues involved and an institutional setting which allows the planner to make the correct decision by utilizing this information. Grossman considers the primary concern of coordinative planning as material balancing by the most expeditious method. This balancing problem is rendered more difficult in the Soviet system by an endemic logic of haste.[32] In practice the energies of Soviet planners are almost completely absorbed with attempts to balance physical quantities with little regard for efficiency and alternative uses.

Material balancing on an input-output basis consists of a successive approximation of aggregates.[33] Balancing and coordination in the upper echelons of the planning structure deal with aggregates of a national magnitude and attempt to achieve consistency between the tasks outlined for the economy by long range goals and the actual capacity of the economy as determined by last year's production information modified by a growth coefficient. These nationally balanced aggregates are subdivided and rebalanced as the plan follows the institutional structure down to the lower levels of the economy until finally, at the regional Sovnarkhozy or sector level, the sector aggregates are balanced in terms of physical units of output and input for that specific product or product mix. This use of input-output relationships was rather crudely applied by Soviet planners in the beginning and discrepancies in the planned balances were corrected by ad hoc directives which altered the

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[32] Grossman, p. 142.

[33] Wellisz, p. 174.

plan in the direction of the priorities of the planners during the actual implementation of the plan. This method allowed for satisfactory balance among the major areas of the national economy with the wastes and imbalances at the sector levels more than offset by the achievement of a rapid growth rate which was the primary objective of the planners.[34] But this very growth rate proved to be the nemesis of rationality in Soviet planning.

As this burgeoning growth rate induced an industrial metamorphosis of the Soviet economy, the need for micro-balance, as well as macro-balance, became apparent. As the economy grew, the obsession with growth by the planners could no longer take precedence over solving the problems of wastes and imbalances at the sector levels and the widening differential between the development of priority and non-priority sectors. Serious consideration of micro-balance became a rational necessity. This additional emphasis has resulted in an increasing interest on the part of Soviet planners in input-output calculations of the Leontief type and the applicability of linear programming to short term planning and capacity limitations to the points that old-fashioned bureaucrats are now working side by side with mathematically trained technicians.[35] But incorporating rationality into Soviet planning by improving methods of balancing and coordination must be done efficiently.

Efficiency and Pricing

Efficiency in planning raises the questions of calculation and

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[34]Campbell, p. 49.

[35]Wellisz, pp. 148-52.

allocation. In order to allocate a resource to its most efficient use, an economic calculation must determine this use to be more productive than that of any alternative use; or conversely, a resource should not be allocated to any use which is less productive than some other alternative. Efficiency includes the necessity for calculation which in turn relies on some common measure, such as prices. Consequently, a discussion of efficiency in planning requires a description of the role of prices in the Soviet system and the process by which these prices are determined.

Bornstein describes prices in the Soviet economy as a system of prices which is manipulated by the central authorities as one of various instruments intended to accomplish their planned goals, and not an autonomous force determining production, resource allocation, and consumption.[36] These administered prices are not what Schumpeter refers to as a coefficient of economic choice, in that by paying a price for any commodity, buyers show a preference for that commodity as compared with other commodities which they could also buy for the same money.[37] The Soviet view of prices holds that it is wrong to attach scarcity prices to reproducible goods in that this merely confuses calculations of real cost, which, in the long run, will be determined not by relative scarcities but by the costs at which, when the planners so decide, the scarce commodity could be produced. And

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[36]Morris Bornstein, "The Soviet Price System," Comparative Economic Systems, (Homewood, Illinois, 1965), p. 279.

[37]Joseph A. Schumpeter, "Price as Coefficients of Choice," Capitalism, Market Socialism, and Central Planning, ed. Wayne A. Leeman, (Boston, 1963), p. 131.

[38]Nove, p. 292.

since this decision will be made by the planners and not based on the profit motive, there is no reason torreward anyone with extra income just because there is a temporary scarcity, but rather, these scarce commodities should be rationed until such time as the planning authority is able to make their supply plentiful. However, while prices can be set to equate supply with demand according to planner's preferences, these preferences cannot themselves be based on an independent calculation of opportunity costs, as reflected in independently determined scarcity prices, since the scarcity prices in use are themselves fixed on the basis of planners' preferences. With this description of the Soviet attitude toward pricing, the discussion may be directed now to the various categories of prices and the rationale by which they are administered.

Soviet prices are classed by Alec Nove as retail, industrial, and agricultural.[39] Agricultural prices will beomitted from this discussion. State retail prices supposedly are fixed with the aim of clearing the market both in aggregate terms and for each commodity. Briefly, the rule for theadministration of retail prices is to set these prices so that in purchasing the total of goods made available, the consumers will just exhaust their total money incomes and so that the planned supply of each individual good just matches the expected demand for that good. This pricing process is referred to by Campbell as an attempt to achieve macro- and micro-balance in the market.[40] To aid the achievement of this balance, Soviet planners utilize a turnover tax which serves as a cushion

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[39]Ibid., p. 135.

[40]Campbell, pp. 86-87.

to separate the retail prices paid by households and the industrial prices received by producing enterprises and at the same time provides the planners with a convenient mechanism for altering consumer prices without altering producer prices, correspondingly, and vice versa.[41] Industrial prices are supposed to be based on the average cost of production of all enterprises producing the commodity in question, plus a small profit margin, often defined in Soviet textbooks as 3-5 per cent.[42] However, Campbell points out that in practice industrial prices have usually departed considerably from the actual costs of production and customarily do not include any charges for rent or capital and seldom reflect the use value to the customer.[43] These disparities in industrial prices on the inter-firm and inter-industry level lead to less than perfect allocative decisions by the planners.

Allocative efficiency requires price parameters that reflect fairly accurately opportunity costs and social worth, but prices in the Soviet Union have traditionally performed the function of head office accounting control over managerial behaviour. The difficulties of the price system are accentuated further by the existence of State subsidies and the subsequent variation between profit and loss differentials within certain sectors and industries. This distortion of the calculated profitability of various industries has effects on the allocation of capital to the most productive use.

The planners may allocate capital to the most productive user on

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[41]Bornstein, p. 302.

[42]Nove, p. 136.

[43]Campbell, p. 81.

the basis of profitability calculations, but given the distortions and imperfections of the Soviet price system, this allocation may not be the most efficient, but the weaknesses of the price system are not the only problems encountered in capital allocation. The rational allocation of capital by the Russian planners was originally thwarted by Marxian orthodoxy itself, which, of course, denies the productivity of capital. The Russian planners circumvented this difficulty by using the payoff period approach to capital allocation.[44] In considering different investment projects, they ask how long it will take for the cost savings in the production process to recover the additional capital.[45] This is merely a back door interest rate expressed as a function of time rather than the usual return to capital. However, even this relatively rational mechanism of calculation can not obviate the problem of determining a reasonable payoff period or of comparing opportunities in two different industries which by nature of their operation are not even remotely similar in industrial activity or time needed for the activity.

These problems associated with efficiency and pricing, balance and coordination, and the success indicators are becoming more important to the planners as the Soviet economy grows in size and complexity. The more interdependence there is among economic decisions and the more alternative choices available to the planners, the more difficult it becomes to provide the planners with information and rules which will

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[44]Campbell, p. 58.

[45]Nove, p. 219.

enable them to make a rational choice.[46] According to Campbell, these weaknesses of the Soviet system have become more serious and the traditional forms of planning have become obsolete as the economy has grown.[47]

Trends in Soviet Economic Thought

These problems and their increasing severity have led Russian economists to investigate possible solutions, especially in the area of reforms in planning and administration. Consequently, a new controversy has arisen in Soviet economics which Goldman compares to the Great Industrialization Debate of the 1920's.[48] The death of Stalin in 1953 opened the door to a revival of economic thought in Russia; however, as early as 1939, Kantorovich published a work on linear programming, and Novozhilov was working along similar lines as early as 1946.[49] Both men were concerned with using computers to establish prices for both factors of production and commodities which would supply a more adequate guide to choice between alternatives.[50] Nemchinov tried to devise an acceptable compromise of the Novozhilov-Kantorovich ideas, but the efforts of E. G. Liberman to investigate plan making and administration and his proposals for reform are perhaps the best known of any of the participants in this new controversy. According to Goldman, the

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[46]Campbell, p. 103.

[47]Ibid., p. 104.

[48]Marshall Il Goldman, "Economic Controversy in the Soviet Union," Comparative Economic Systems: A Reader, (New York, 1964), p. 347.

[49]Nove, p. 290.

[50]Ibid., p. 291.

Liberman proposals have become the focus of one of the most provacative and far-reaching discussions in Soviet economic thought. And the focus of the discussion of this thesis is now directed to the Liberman proposals.

CHAPTER III

THE LIBERMAN PROPOSALS

In drafting his proposals, E. G. Liberman* was primarily concerned with a reform of the Soviet economic administration which would allow a more effective use of the country's economic resources. His suggestions called for improvements in planning efficiency and operating incentives with more emphasis on markets, prices and profit considerations. However, before turning to the development of these proposals and the specific suggestions they contained, an over-view of the general nature and intent of the proposals is briefly presented.

The basic intent of Liberman's proposals is to provide more freedom for the plant manager, more intelligent use of resources, and accordingly more efficiency through a reform of Soviet planning.[1] Essentially, this reform calls for a decentralization of planning with the attendant increase in enterprise decision making based on the profit motive.[2] This decentralization must rely principally on an elimination of the system of concentrating on gross value of output and undue and excessive

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[1]Goldman, p. 350.

[2]Nove, p. 233.

interference in the firm's operation by superior agencies.[3] According to Goldman, Liberman's suggestions for Soviet economic reform in the direction of decentralization and increased freedom for the firm outline three main goals: (1) to stimulate Soviet enterprises and firms to seek higher output targets for themselves, (2) to encourage the introduction of new technology and new products, and (3) to improve the quality of production.[4] These general elements contained in Liberman's proposals represent the end result of many years of attention given to the problems of planning by Liberman.

On September 9, 1962, the Liberman proposals were published in Pravda, and for many western readers, this was their first exposure to "new" trends in Soviet economic thought. However, this was not the first time Liberman had advanced ideas of reform in the economics of Soviet planning with specific reference to the problems encountered at the firm level. As early as 1955, in an article to Voprosy Eknonmiki, Liberman urged that each enterprise should have a 'long-term economic perspective' on which it could rely, for five to seven years ahead, in terms of which its efficiency should be measured; such objective criteria of efficiency should be output relative to basic and working capital, labor productivity, and profitability.[5] Liberman regarded a reform of this nature of vital importance before firms would be able to consider long-term development or would be free from the distortions which arise from attempting to fulfill the ever changing plan indicators. Then

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[3]Goldman, p. 348.

[4]Ibid.

[5]Nove, p. 246.

again in 1959, in an article to the Kommunist, Liberman formulated proposals which were more far-reaching than those of 1962 in that he then advocated openly the dismantlement of the materials allocation system, while at the later date, he thought it best to keep silent on this point.[6] In the promulgation of all these proposals, including those of 1962, Liberman was primarily concerned with the situation of the individual industrial enterprise.

In the opening statements of his 1962 proposal, Liberman summarized the problems faced by the individual enterprise:

> The present procedure of planning the work of enterprises stifles their initiative, does not permit the maximum utilization of production potentialities and the advantages of the new system of management, and does not make enterprises interested in further raising the efficiency of production. This is suggested by countless facts, by statements of industrial executives and scientists.[7]

The 'present procedure of planning' to which Liberman referred was characterized by a large number of different plans and instructions handed down to the firm from above by different planning offices operating in many cases with imperfect information. These directives from above would prove restrictive enough to initiative if they were consistent with each other, but more often than not, the criteria set forth in the various instructions were conflicting. Consequently, firms were forced to adjust their productive activity and to choose which elements of an inherently inconsistent plan to fulfill. Enterprise managers were motivated to bid low and understate their productive

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[6] Nove, p. 248.

[7] Evsei Grigorievich Liberman, "Planning Production and Standards of Long-Term Operation," Problems of Economics, (Vol. #8, Dec., 1962), p. 16.

potential in an effort to influence their planning superiors to give them an easy plan, because even in a command economy, the top planners must receive information from below with which to formulate plans. In addition to the loss of efficiency associated with this tendency of managers to understate potentials, the system of rewards and penalties faced by managers in attempting to fulfill planned targets often resulted in the production of obsolete or inferior goods and a tendency to avoid innovation. In short, managers were motivated to fulfill the plans at any cost, regardless of quality, durability, and reliability of the output.[8] It was the existence of these induced inefficiencies at the firm level which caused Liberman to suggest changes in the relationship between the enterprise and the planning authority relative to instructions, indicators, autonomy, and incentives.

Indicators and Autonomy

The first point that Liberman makes in his proposals is that "only the key indices, the decisive indices, should be handed down to enterprises, whose directors would be given greater rights and opportunities for economic maneuvering within their scope."[9] The implication of this statement is that the planning process should be improved in its efforts to achieve maximum output and efficiency through simplification of existing procedures. The planning instructions from above should contain indices as to how much and what kinds of outputs to produce, and, as the

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[8]Alec Nove, "The Liberman Proposals," Survey, (London, April, 1963), p. 113.

[9]Liberman, p. 16.

second basic assignment of the firm, the additional index of profitability of an enterprise must be handed down. But, the enterprise should be given the right and obligation, independently and completely, to elaborate technical-production-financial plans on the basis of the output target planned for them 'from above.' The enterprise should construct its own labor, wages, costs, and profit plans. Liberman justifies this simplification of the role of the central planners via increased autonomy on the part of the firm with the statement:

> What is profitable to society as a whole will also be profitable to each production collective, and on the other hand, what is wasteful from the standpoint of public interests will be extremely unprofitable to each enterprise.[10]

This suggestion for decentralization with an increase in planning from below necessitates a clear criterion of efficiency to which managerial decisions would be related.

Liberman describes his criterion of efficiency as the "share-in-the-income" principle which is realized in the form of a planned long-term standard of profitability of production.[11] This basic criterion of profits, expressed as a percentage of the enterprises' capital, both fixed and circulating, is the essence of the Liberman plan. This basic index of profitability relative to the capital of the firm would be formulated by drawing up a standard scale of deductions from profits for uniform groups of enterprises within each branch of industry, and these deductions from profit would be put at the disposal of the firm with the remaining profit collected by the state as revenue.

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[10] Ibid., p. 17.

[11] Ibid.,

Liberman illustrates this standard scale of deductions from profits as a percentage of assets with an example using the machine-building industry. This table of deductions from profits is an approximation based on an analysis of date of the operation of 23 machine-building plants over a five-year period, with the scale of deductions expressed as a logarithmic function of profitability.[12] The table is divided into seven columns showing the different intervals of profitability expressed as a percentage of assets. The financial reward or retained deduction from profit is listed in two parts. Row 1 shows the financial reward in percentage of funds which may be retained from the profit. Row 2 shows the additional reward which may be retained as a percentage of any profits exceeding the lower limit of the profitability interval. Liberman was careful to point out that the scale of deductions from profit available to the firm would increase, but would increase less than proportionately to profits. The larger part of the increase in profits would go to the state and would benefit and not harm revenues.[13]

A hypothetical calculation using this scale of deductions for determining financial rewards at different levels of profitability for a machine-building plant may prove helpful at this point. With the initial assumption that a given machine-building plant is operating so that its profitability is 5.1 percent of its total assets for a given quarter, let us also assume, for the sake of simplicity, that its total assets amount to 1000 rubles. The total profit for this period of operation would be 51 rubles. Reading from Column 2 of Table 1, we see

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[12] Ibid.

[13] Ibid.

TABLE I

SCALE OF FINANCIAL REWARDS FOR ENTERPRISE DEPENDING UPON LEVEL OF PROFITABILITY[14]

Financial Reward	Profitability (In Percent of Assets)						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	0-5	5.1-10	10.1-20	20.1-30	30.1-45	45.1-60	60-100
(1) In Percent of Funds	-	2.1	3.0	3.9	4.4	4.9	5.3
(2) Additional (in Percent of Profits Exceeding the Lower Limit of the Interval)	42.0	18.0	9.0	5.0	3.3	2.7	2.0

[14]Liberman, p. 18.

that this firm is allowed a financial reward of 21 rubles and that the remaining 30 rubles are received by the state as revenue. At this level of 5.1 percent profitability, no additional financial rewards are available to the firm, but now let us assume that with the same asset base, the same firm is able to increase its profitability to 10 percent of its assets. Now the total profit of the firm is 100 rubles. The initial financial reward of 21 rubles is available at this level of profitability as indicated by Row 1 of the table, and there is also the additional reward to be calculated from the excess of profits over the lower limit of this profitability interval. This excess profit is 49 rubles or 4.9 percent of the assets (the amount by which the profit of 100 rubles exceeded the profit of 51 rubles at the lower limit of this interval, i.e. 100 - 51 equals 49 or 10 percent - 5.1 percent equals 4.9 percent). The portion of this excess profit of 49 rubles which the firm may retain as an additional reward is indicated in Row 2 of Column 2 as 18 percent. Calculation of this amount indicates that the firm will receive an additional reward of 8.82 rubles and adding this amount to the initial reward of 21 rubles gives the firm a total of 29.82 rubles at the 10 percent profitability level.

Now, one further step in this hypothetical case and the illustration will be complete. Assume the same firm with the same asset base increases its profitability to 10.1 percent of its assets. The financial reward of the firm at this level of profitability is 30 rubles as indicated by Row 1, Column 3, and there is no excess profit over the lower limit of this interval upon which to make a calculation for additional reward. But it is important to note that this lower limit of the next

profitability interval yields a greater financial reward than did the highest limit of profitability in the preceeding interval. A brief tabular presentation of this hypothetical calculation is shown in the following passage to clarify the relationship between the upper and lower limits of each consecutive interval.

Profitability (In Percent of Assets)	Total Profit	Financial Reward	State Revenue
5.1 (Lower Limit)	51 r.	21 r.	30 r.
10.0 (Upper Limit)	100 r.	29.82 r.	70.18 r.
10.1 (Lower Limit)	101 r.	30 r.	71.r.

Thus, at profitability levels of 5.1 percent, 10 percent, and 10.1 percent, the firm received financial rewards of 21, 29.82, and 30 rubles respectively and the state received 30, 70.18, and 71 rubles respectively.

Liberman maintained that his index based on the profitability of each firm would make firms unconditionally interested in improving all production indices both in the process of elaborating the plan and in the course of its fulfillment, and in so doing, obviate the necessity of handing down any other indices to the firms.[15] In short, by tying the incentive fund of the enterprise to the retained deductions from profits expressed as a percentage of assets, the incentive of managers to attain maximum output and efficiency would be achieved via the interest of the manager in his own pocketbook.

Incentives

Liberman used profitability as a percentage of assets as the

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[15] Ibid.

underlying principle in providing incentives to managers. He stipulated the rule that deductions from profits placed at the disposal of an enterprise must be the single and sole source of payment of all types of financial rewards.[16] The incentive fund would become the only source from which managers could finance decentralized investment and pay bonuses. Additionally, any sanctions levied against the firm by superior planning authorities must also be paid from this incentive fund. Consequently, the managers would be motivated to choose courses of productive action which would yield the greatest net product in relation to their capital assets.

Liberman felt that the enterprise itself knew its potential best, but at the same time, he was aware of the problem of persuading enterprises to bid high and not understate their potential in drafting their part of the plan. To solve this problem, he conceived an ingenious device by which the incentive fund benefits less from overfulfilling than from fulfilling a given profits plan.[17] This concept relates back to the fact that Liberman stipulated that the enterprise submit its complete plan to include the profit plan. He states that "under the suggested system of planning, an enterprise will receive deductions from profits based on the percentage of profitability included in the plan which the enterprise itself draws up."[18] If the firm director draws up an ambitious plan and does not achieve the planned level of profitability, then the deductions from profit will be computed on the

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[16]Ibid., p. 18.

[17]Nove, p. 133.

[18]Liberman, p. 18.

actual profitability achieved, but if the firm director draws up a plan which understates the actual profitability achieved, then the deductions are computed from the percentage of profitability stated in the plan. This does not actually restrain a tendency on the part of managers to attempt to overfulfill their plans, because the excess profit incurred would be subject to deductions for the use of the firm, but these deductions would be at the rate stipulated by the firm's own plan. But the most important point is that with this method, there is no advantage to be gained by understating potentials.

Closely associated with the incentive to state potentials honestly in the plan formulated at the firm level, is the additional incentive to minimize production costs. Since profitability depends on the direct reduction of production costs, firms would lose all desire to draw in additional labor power or use the most expensive materials of production. In fact, Liberman suggests that such an attempt to purchase inputs as cheaply as possible will influence the production decisions of suppliers without any official instructions from above.[19] With profitability expressed as a percentage of assets, firms would find it unprofitable to obtain unnecessary equipment and excess capital investments both of which contribute to costs of production.

Profitability would not only motivate the firm director to attempt to minimize costs and maximize efficiency, but also to innovate. The incentive to innovate requires some degree of security on the part of the innovator that the rules governing additions to the incentive fund will remain unchanged for a long enough period of time to enable the

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[19] Ibid., p. 20.

innovation to mature and contribute to the profitability of the firm. Liberman makes this necessary requirement clear in his reference to the continuity of production and the need for long-run stability in the profitability indices.[20] There would be small incentive to innovate new techniques or improve the quality of existing products if the costs incurred could not be recovered before the profitability indices were changed detrimentally. But despite the fact that Liberman insists that the profitability indices should remain constant for at least the same period of operation as a given set of wholesale prices, he admits the need for price changes associated with innovation and product improvement.[21] According to Liberman, if a product offers its user the possibility of additional applications, a corresponding addition to its price should be established to increase the profitability of production and allow the firm to fully recoup the increase in outlays of labor and materials connected with improving the quality of the product.[22] These price changes should be approved by the central authorities only after they have been mutually checked by enterprises on the basis of direct ties established between suppliers and buyers.[23]

Liberman's proposal for planning production and establishing standards of long-term operation at the firm level based on the concept of profitability is an attempt to improve the existing planning

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[20]Ibid., pp. 17, 18, and 20.

[21]Ibid., pp. 17 and 20.

[22]Ibid., p. 20.

[23]Ibid.

procedure via simplification. According to Nove, the proposed scheme would free central planning from the task of detailed supervision of firms and from costly attempts to influence production not by economic but by administrative means.[24]

[24]Nove, p. 114.

CHAPTER IV

RUSSIAN REACTIONS TO THE LIBERMAN PROPOSALS

The Liberman Proposals precipitated a discussion of the role of market forces and profits in a planned economy of the Soviet type. Some of the opinion generated openly rejected the proposals as dangerous to planning, per se, and implied that such proposals betrayed the achievements of the revolution. Otherwriters admitted the proposals had some merit, but could not agree with them completely and took issue with specific parts of the proposals. Still a third group of writers endorsed the proposals and suggested additional measures along the same lines as Liberman. A representative sample of these various opinions will be presented at this point to provide a basis from which to evaluate the proposals.

As one example of outright opposition we may look at the reaction of A. Zverev, former USSR Minister of Finance, to the Liberman proposals with a statement of his opinion:

> The basis of the concept which E. Liberman advances seems to me to be dubious, insufficiently thought out and inconsistent. Liberman takes an oversimplified and sketchy approach to the solution of an extremely complex problem.[1]

Zverev also asserted in October, 1962, in Ekonomicheskaya gazeta that

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[1] A. Zverev, "Against Oversimplification in Solving Complex Problems," Problems of Economics, (Vol. V, #12), p. 16.

"Planning is one of the principle achievements of the October Revolution; why abandon it?"[2] Zverev supports his opinion with an argument consisting of two main parts. Half of this argument revolves around theoretical considerations, and the other half divides the Liberman proposals into four specific areas and considers these divisions individually.

Zverev opens his attack on the Liberman proposals by stating that it is impossible to replace the role and power of state planning by establishing an average profitability rate for all enterprises, and that in fact, such an "innovation" would be detrimental to the economy.[3] Adoption of the Liberman proposals, according to Zverev, would precipitate difficulties on the national level in drawing up the overall financial plan of economic development and in the distribution and redistribution of the national income on branch and territorial basis; additionally, adoption of these proposals would weaken the role of the State Planning Committee, the economic councils and financial organs in planning costs and bringing the quotas down to the enterprises.[4]

Finally, Zverev notes that Liberman's usage of profitability and profits contradicts the generally accepted theoretical concepts.[5] The "accepted theoretical concepts" of profitability and profits to which Zverev refers are those built around the Marxist concept that profit is the main part of the surplus product created by the workers' surplus

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[2]Nove, The Soviet Economy, p. 250.

[3]Zverev, p. 18.

[4]Ibid.

[5]Ibid., p. 18.

labor. In his proposals, Liberman implies that profit arises not only from the labor embodied, but also from the fixed and current assets. This is, of course, theoretically at odds with the Marxist concept of the sterility of capital. Not only do the Liberman proposals violate the traditional concepts of Marxist value theory, but they also violate the methodological basis of price formation in a planned socialist economy by relating price to production, which in Zverev's opinion is characteristic of the capitalist system of economy.[6]

With this indictment on the theoretical level, Zverev proceeds to criticize the Liberman proposals on a point by point basis. Zverev summarizes the Liberman proposals into four main statements for purposes of his appraisal: (1) The only centralized targets handed down to the enterprise should be the volume and composition of production. (2) Enterprises and workers should receive premiums for fulfillment of the fixed profitability standard, with higher premiums for overfulfillment of profitability indices. (3) The enterprise should decide the remaining indices, including the amount and direction of investment. (4) Profits and profitability should no longer be drawn up in yearly plans, but instead, the planners should establish average, long-term profitability standards for homogeneous groupings of firms.[7]

Zverev begins his criticism of the Liberman proposals by pointing to a contradiction which he feels lies in the relationship between the State Planning Committee and the enterprise as defined by Liberman. Liberman points to the fact that the enterprise knows better than

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[6]Ibid.

[7]Ibid., p. 16.

anyone else its own productive capacities; he argues that the only centralized targets which should be handed down to the enterprise are' the volume and the composition of production. However, Zverev raises the question, "How can the State Planning Committee and the economic councils establish the volume and composition of production for enterprises if they know the production capacities so poorly?"[8] Zverev seems to be implying that according to Liberman's rationale for removing all of the indices from the planning authorities except the "key" index of volume and assortment, it would be just as logical to remove this last index as well. But, as Zverev points out, the State Planning Committee and the economic councils do know the productive capacities of the firms or otherwise they would not be able to plan and direct the productive activities of the economy.[9] However, in making the obvious statement that the planning authorities do know the productive capacities of the firms, Zverev makes no reference to the imperfect quality of this knowledge as a result of the tendency of plant managers to seek easy plans by understating their potentials.

In reference to the tendency of managers to understate capacity, Zverev points out that even if the Liberman proposals reduce this problem, a new bias in managerial behavior might arise as a result of the profitability index. Zverev states that there is no guarantee under the Liberman system of profitability incentives that managers will not understate their capacity and profitability rate with the intention of

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[8] Ibid.

[9] Zverev, p. 16.

overfulfilling the plan and thus receiving more premium funds.[10] However, a careful consideration of the Liberman proposals indicates that the firm will receive more premium if its actual production just matches or even fails to meet the planned target than if it overfulfills the planned target.

The third point of the proposals with which Zverev takes issue is the fact that according to Liberman, the enterprise should draw up the plan for the amount and direction of investment. Zverev raises the same issue here that most of the other critics use, namely, that of achieving macro-balance. He contends that the individual enterprises are ignorant of the complex inter-relationships at the national level, and even if they had such information, they would not be able to achieve the necessary balance.[11] In other words, if this part of the Liberman proposal were implemented, the discrepancies in planning investments and the disproportions in industrial development would be even more serious than they are under the present system.

Liberman's proposal that profits and profitability should no longer be drawn up in yearly plans, but instead should be stated as average, long-term profitability standards for homogeneous groupings of firms is the final area of disagreement noted by Zverev. He points to the fact that production cost is the basic qualitative index of any production plan.[12] It is this index of production cost which reflects reductions

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[10] Ibid.

[11] Zverev, p. 16.

[12] Ibid., p. 17.

in the expenditure of social labor per unit of output, economies in the utilization of material inputs, and innovations in the technical methods of production. Consequently, the central authorities must have control of the cost quotas for enterprises in order to balance labor and material resources at the national level.

Briefly, Zverev took issue with the Liberman proposals in their entirety, but not all the reaction to the proposals was this extreme. The criticism of B. Sukharevskii, a member of the State Committee on Labor and Wages of the USSR Council of Ministers, is an example of that part of the Russian reaction which found both good and bad points in the Liberman proposals. Despite the fact that he did not agree with the proposals completely, B. Sukharevskii found several points with which he could agree. In fact, Sukharevskii implies that certain aspects of the Liberman proposals have a substantial potential for future improvement of the Soviet method of planning.

The Liberman proposals are discussed by B. Sukharevskii from two points of view; one is the general or macro-approach and the other is a more specific, micro-investigation. In his general approach to the proposals, Sukharevskii refers to Liberman's key index of profitability based on assets as an "automatic self-regulator" and admists that Comrade Liberman is moving in the right direction.[13] However, Sukharevskii takes issue with Liberman's proposals on grounds which resemble a fallacy of composition type argument. He states that:

> The root of the mistake of this proposal lies in the fact that it ignores the unity of physical and value

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[13] B. Sukharevskii, "On Improving the Forms and Methods of Material Incentives," Problems of Economics, (Vol. V, #12), p. 4.

> relations in social reproduction and confuses the conditions of reproduction of a single enterprise with those for the national economy as a whole.[14]

Sukharevskii seems primarily concerned with balance at the macro-level in maintaining that the individual enterprise is closely related to the national economy via commodity-money relationships which occur in both physical and value terms. He maintains that proper proportions must be ensured both in physical and value terms in order for an economy to develop on a planned basis. Sukharevskii admits that the Liberman proposals satisfy the requirements of physical balance between money income and available commodities must be maintained and that profitability is not automatically self-regulating in this category of balance. Not every increase of profitability will ensure the creation of the necessary material foundation for higher wages; hence the need for planning wage funds for the enterprise from above.[15]

Sukharevskii differentiates between the single firm and the economy as a whole with reference to the applicability of the Liberman proposals. At the firm level, it is possible that the funds resulting from an increase in profitability may be used for investment or raising the wages of the workers. But, according to Sukharevskii, such assumptions hold good only as long as they refer to a single enterprise; as soon as these assumptions are expanded to the national economy as a whole, there is no guarantee that every enterprise will secure the required means of production and consumer goods unless these requirements are planned and

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[14] Sukharevskii, p. 4.

[15] Ibid.

balanced at the national level.[16] Sukharevskii also questions the compatibility of individual investment decisions at the firm level based on profitability and the long-term satisfaction of national economic requirements. Since investment plans affect the balance of pr productive capacities of the economy at their inception and for several years in the future, these investment decisions must be balanced at the national level to achieve the long-run preferences of the central planners for national development. Thus, Sukharevskii argues, centralized planning for enterprises cannot be limited to the so-called quantity-assortment targets; what may be possible for the individual firm is not necessarily guaranteed automatically for the economy as a whole within the constraints of the need for macro-balance in the investment-commodity markets and the desire of central authorities to pursue specific long-run investment plans.

After his discussion of the Liberman proposals with reference to the general view, Sukharevskii considers the proposals in a specific context with the major emphasis on incentive indices and the standards by which these indices are evaluated. Sukharevskii feels that the Liberman type profitability index based on assets has advantages over the other indices of output, labor productivity, and production costs. He lists three main advantages of the profitability index over alternative indices; First, profitability reflects changes in both quantity and quality indices of plant operation; second, profits reflect a social evaluation of the expenditure of labor which society considers necessary

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[16] Sukharevskii, p. 5.

because these profits depend on prices; and third, profitability reflects the extent of utilization of productive assets to include both living labor and material labor.[17]

But Sukharevskii also points to the fact that an index based on profitability alone does not provide a dynamic measure of the forward movement of the operations of the enterprise.[18] Sukharevskii states that:

> Since the formation of the bonus fund depends only on the profitability achieved, the enterprise will be able to receive substantial bonuses without improving its work as compared with the already achieved level.[19]

He, therefore, recommends that whether the index used is output, labor productivity, production costs, profit or something else, the index should be based on the improvement of plant operation with the bonus rate differentiated to take into account the achieved level. Sukharevskii argues that with his bonus scheme, regardless of the level already achieved, the firm will be stimulated to improve its work from one period of operation to the next.[20]

Two other disadvantages of the profitability index to which Sukharevskii calls attention are the problems associated with the indivisibility of the incentive fund when this fund is determined by the single index of profitability, and the heterogeneity of industry, per se. Sukharevskii contends that the incentive fund should facilitate the stimulation of both individual and collective incentives, but that

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[17] Sukharevskii, p. 9.

[18] Ibid., p. 6.

[19] Ibid.

[20] Ibid., p. 6.

when the whole incentive fund is based on profitability alone, it is difficult to divide the bonuses into shop and section levels.[21] Briefly, he believes that the profitability index works well enough in providing collective incentives to the firm as a unit, but that the total operation of the firm is the result of different categories of workers whose contribution to that total operation is not always the same. Thus, to maintain individual incentives as well as the collective incentive, the material incentive fund should not be uniform: enterprises should have specialized funds for specific categories of their operation, e.g. a bonus fund for engineering-technical personnel and office employees, a bonus fund for new machines, etc.[22]

Sukharevskii gives Liberman credit for taking a step in the right direction in formulating the profitability indices differently for different groups of similar firms within an industry, but he adds that in the future another step forward should be made: the prices according to which the enterprises market their output should be differentiated for groups of enterprises.[23] But, Sukharevskii's suggestion relative to prices takes his discussion into the realm of standards by which to evaluate Liberman's profitability index.

He agrees with Liberman that standards of evaluation should be established for at least two or three years and that firms with similar operating conditions should be grouped together under the same

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[21] Ibid., p. 10.

[22] Sukharevskii, p. 11.

[23] Ibid., p. 8.

profitability index, but he adds to Liberman's suggestions a consideration of prices in evaluating profitability. At the present, Soviet prices are based on average costs in an industry plus a given profit margin and are not adapted to separate groups of related enterprises. This present profit calculation included in pricing procedures is based on the ratio of profits to production costs and not the asset base of the firm. Consequently, if material incentives are to be established on the basis of a certain relationship of profits to assets, this sould be taken into account in the price structure as well.[24] Additionally, the present price system attempts to reconcile the conditions of production and to stimulate a certain structure of consumption. In that profitability calculations are based on prices, these calculations reflect both the conditions of production and at the same time, the desired structure of consumption. But, if the profitability index is to become the basis of material incentives relative to production, the profitability calculation must be linked with the requirements of producing the goods in questions.and not the prices set by the planners in an effort to clear the market of these particular goods.[25]

With these suggestions for changes in the price system, Sukharevskii proposes an improvement of the material incentive system in two stages: In the first stage, measures should be taken that can be carried out before a general adjustment of prices is undertaken, and in the second stage, measures should be taken together with the price adjustment.[26]

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[24]Sukharevskii, p. 9.

[25]Ibid.

[26]Ibid.

In essence Sukharevskii is suggesting, within the constraints of the existing price system, an implementation of the Liberman proposals for a profitability index to improve the material incentive system. But at some future time, he suggests changes in the price structure which will take Liberman's profitability index into consideration and, in fact, reinforce the effectiveness of the index in providing incentive to the individual firm.

In his discussion of the Liberman proposals, Sukharevski uses the points with which he agrees as a basis for making further suggestions of reform, especially with reference to the Soviet price system. Another writer whose reaction to the proposals is similar to that of Sukharevskii is I. Kasitskii. He, too, agrees with Liberman's proposals in part, but he also suggests changes which would, in his opinion, improve the proposals.

I. Kasitskii is associated with the Committee on Economics and Production of the USSR Council of Scientific and Technical Societies.[27] He agrees with the Liberman proposals on basically three points. In reference to indices in general, Kasitskii admits that there should be long-term stability of indices and that these indices must be carefully differentiated for different groupings of similar enterprises.[28] He also concedes that the plan should not be the decisive index, but in order to avoid casting planning aside, Kasitskii stipulates that the plan must be a prerequisite for premium awards or bonuses.[29] In other words, there

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[27]I. Kasitskii, "The Main Question: Criteria for Premiums and Indices Planned for Enterprises," Problems of Economics, (Vol. V, #12), p. 12.

[28]Ibid., p. 14.

[29]Ibid., p. 13.

should be a planned target which must be fulfilled in order to receive an incentive reward, but this bonus should be calculated on some index other than output or plan fulfillment. In this respect Kasitskii's agreement with the Liberman proposals is quite similar to that of Sukharevskii, but in his appraisal of Liberman's profitability index, Kasitskii introduces different considerations.

Kasitskii opens his discussion of profitability with the statement that profitability has always been defined in economic practice and literature as the percentage relationship of profits from sales to production cost of the goods sold.[30] He then goes on to contrast this usual definition with Liberman's concept of profits expressed as a percentage of assets. Kasitskii does not hesitate to point out that Liberman's profitability index is nothing more than a capitalistic concept of the rate of profit on invested capital. He then lists the possible disadvantages which might arise at the firm level by using Liberman's concept of profitability.

By using the index of profitability as a percentage of assets, Kasitskii maintains that this would induce the firm to be primarily interested in reducing the denominator of such a relationship, i.e. assets. This inclination on the part of firm directors to reduce assets would have a positive effect on the operation of the firm relative to current assets, but not so with fixed assets. In reference to fixed assets, Kasitskii feels that profitability based on assets would result in technological stagnation, no improvements in utilization of machinery

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[30]Ibid., p. 14.

and finally a reduction of investment in fixed assets.[31] It is the last of these with which Kasitskii takes particular issue. He contends that any tendency on the part of an individual enterprise to reduce investment in fixed assets may conflict with the national planning preference of the central authorities.

This concern with the relationship of the central planners to the individual enterprises also leads Kasitskii to contest Liberman's proposal that profitability serve as the key index. Kasitskii points out the importance of central control over labor resources and wage funds in order to maintain national balance in labor markets, to affect currency circulation, to strengthen the ruble and to regulate retail trade.[32] Consequently, Kasitskii concludes that even though profitability expressed as a percentage of assets is an important index, it should not be the only index, but rather, since both profits and prices in the Soviet economy have been related to costs of production in practice, the cost of production index should be considered the key index with the other indices merely supplementing its effectiveness.

Three other writers whose views are similar to those of Sukharevskii and Kasitskii are summarized briefly and collectively. In presenting their criticism, emphasis is placed on those viewpoints original to their discussion of Liberman's proposals, and areas in which there is general agreement with the other writers are mentioned en passant.

In their respective discussions of the Liberman proposals, G. Kosiachenko, K. Plotnikov, and L. Al'ter express the common opinion

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[31] Ibid., p. 14.

[32] Ibid.

that Liberman in seeking a solution to the problems of planning makes the mistake of isolating the individual enterprise from the national economy as a whole.[33] They feel this leads Liberman to rely on the profitability index as an automatic "self-regulator" which along with volume and composition of output is the only target the central authorities should hand down to the firm. In addition to their collective objection that this proposal, if implemented, would weaken unified national economic planning, they also indicate the necessity of central control over both investment and wage fundsplanning or serious national imbalance in industrial development and both the commodity and producer goods markets will result.

They agree with the Liberman proposal in reference to the calculation of indices for groups of similar industries, but take issue with Liberman's use of only one key index-profitability. Plotnikov states that the indices should be differentiated according to branches of industry and types of production, and that an enterprise's work should be assessed with the help of a set of indices, both in value and physical terms.[34] Kosiachenko refers to the same thing in stipulating that in addition to certain common indices for all branches, it is necessary to establish specific indices for each branch of the economy.[35] Al'ter

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[33] G. Kosiachenko, "Important Condition for Improvement of Planning," Problems of Economics, (Vol. V. #12), p. 21.

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K. Plotnikov, "E. G. Liberman: Right and Wrong," Problems of Economics (Vol. V. #12), p. 24.

L. Al'ter, "Incentives Must Be Linked with the Long-Term Planning of an Enterprise," Problems of Economics, (Vol. V. #12), p. 26.

[34] Plotnikov, p. 25.

[35] Kosiachenko, p. 22.

arrives at a similar conclusion in his statement that the role of profits must be raised, long-term standards should be introduced into the material incentive system, and high plan assignments must be stimulated, but these three elements should not be viewed as an automatically functioning mechanism which will eliminate the need for planning other important indices such as labor productivity, production costs, wage funds, capital investment, supplies and innovation.[36]

All of the discussions presented thus far have contained various degrees of agreement and disagreement with the Liberman proposals, but V. Nemchnov, Director of the Laboratory of Economic and Mathematical Methods of the USSR Academy of Sciences, attempts to reconcile these various schools of thought by emphasizing the positive approach; he states: "We should establish what unites us with E. Liberman and not what disunites us."[37] The first point upon which there should be general agreement is the necessity for a system which would stimulate the enterprise to demand the most intensive plan and report its capacity honestly. Nemchinov also insists that fixed assets should not be cost-free.[38] There should be a charge associated with the expansion of production in order to take into account the resources used in this expansion. Additionally, profitability planning should not be based on production costs alone, but should also take into consideration the extent to which the production process is provided with fixed assets. The final common ground of opinion according to Nemchinov, is that the

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[37] V. Nemchinov, "Making Enterprises Interested in More Intensive Plans," Problems of Economics, (Vol. V, #12).

[38] Ibid.

enterprise requires a single source for its incentive fund, but not necessarily established by a universal index.[39] These are the common points of agreement from which the Liberman proposals must be considered and from which the possibilities of compromise must be explored.

Nemchinov attempts to reconcile these various criticisms not by defending the minor points and details over which controversy arose, but rather by suggesting changes in two basic areas of Soviet economics - material allocation and the price system. These changes, if implemented, would provide a framework within which the Liberman proposals would assume greater validity than they would under the existing system.

In the Kommunist, in 1964, Nemchinov suggested a scheme which would place more emphasis on enterprise initiative, and at the same time reduce the materials allocation system to price control over the minimum amount of basic materials, fuels, and a few essential consumers' goods.[40] Nemchinov suggested that the planning authorities place orders among various enterprises according to plan requirements, but these state orders would be in terms of final goods and not intermediate goods. The enterprise would submit in advance its proposals as to how it would carry out a certain planned order with respect to assortment, quality, delivery date, and price.[41] This would be very much like a bid for government contract as we know it in the United States.

After having received these "bids," the planning organs would place their orders with those firms whose bids were the best for the national

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[39] Ibid.

[40] Nove, The Soviet Economy, p. 253.

[41] Ibid.

plan. The resulting competition among firms for the state orders would allow the state to satisfy its needs at the lowest cost, and the intermediate goods would be sub-contracted among firms on a mutual trade basis.[42] With this scheme, firms would be motivated by determine their own investment programs based on the requirements of their customers, whether state or individual.

In reference to the price system, Nemchinov had to propose a change which would stress the relationship of value and the satisfaction of wants without openly violating the traditional labor theory of value. Nemchinov asserted that the socially necessary expenditure of labor must be determined by reference not only to the expenditure of labor but also to its results.[43] Nemchinov advocated that this determination be achieved by the use of a "transformed form of value" corresponding to real costs from the standpoint of the national economy arrived at by adding to the prime cost (c + v) an amount composed of a standard capital charge plus a differential rent.[44] Nemchinov expected this differential rent factor to be calculated on computers taking into consideration the relative availability and relative advantages of land, minerals and factories by reference to the intended results and the basic lines of the plan.[45] Nove suggests that Nemchinov's proposal for determining in advance a variable differential rent, a variable profit norm, for different industries and for different enterprises in the same industry permits an

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[46] Nove, p. 297.

[47] Ibid.

[48] Nemchinov, p. 19.

[49] Nove, p. 249.

[50] Ibid.

approach to a marginal basis for price.[46] Nemchinov never openly relates price to scarcity, but insists instead that the surplus product be divided proportionately among the conditions of production in relation to means and needs.[47]

After having made these suggestions, Nemchinov reassures the proponents of planning that he is not trying to abandon the fruits of the revolution with his statement that the shortcoming in planning is not a defect of the system, but rather of the planning practices connected with planning intermediate, rather than final results.[48]

Nemchinov was not the only advocate of a capital charge along the lines of Liberman's suggestion. V. Trapeznikov in an article in Pravda, August 17, 1964, included a charge on capital in his "libermanist" proposals.[49] Liberman's proposals were also endorsed by L. Vagg and S. Zakharov in their suggestions for a revaluation of capital assets.[50] They advocated an annual capital charge of 20 percent of the value of the total capital in an effort to increase the relative costs of the better equipped enterprises. They also admitted that a more rational price system was necessary if capital calculations of this nature were to be effective.

In this resume of Russian reaction to the Liberman proposals, advantages, disadvantages, and suggestions for further improvement of the proposals have been presented. But now the direction of this thesis is

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[46] Nove, p. 297.

[47] Ibid.

[48] Nemchinov, p. 19.

[49] Nove, p. 249.

[50] Ibid.

pointed to a general evaluation of these proposals and their impact on Soviet economic thought. This evaluation will consider the advantages associated with the proposals, the questions raised by the proposals, and the implications involved in resolving these questions.

CHAPTER V

EVALUATION, CONCLUSIONS, AND IMPLICATIONS

The viewpoints presented in the preceding chapter summarize the various advantages and disadvantages of the Liberman proposals as the Russians see them. At this point, an evaluation of the proposals is presented with reference to economic rationality. Balance, coordination, and efficiency are the focal points of this evaluation. The primary question raised by an evaluation of the proposals revolves around the need for balance and coordination between the actions of the central planners and the individual enterprises. This need for balance and coordination at both the macro- and micro-levels is part of Campbell's definition of economic rationality as stated in Chapter II of this paper.[1]

In the discussion of the Liberman proposals, the problem of merging planning with the activities of semi-autonomous enterprises lies at the heart of the controversy. Whether the critics refer to this problem as a threat to planning or to economic and financial balance, the fact remains that if the enterprise is given control of all indices except the key index of profitability standards and a given quantity and assortment of output, there is the possibility that imbalance will occur at the macro-level of the economy. Specifically, imbalance may occur in the investment and consumption sectors of the economy.

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[1]Campbell, p. 29.

It is conceivable that taken individually, each firm could determine its own investment program, but when considered collectively within the constraint of the existing materials allocation system in Soviet planning, there is the possibility that the total of autonomously directed investment may not balance at the macro-level. If each firm is allowed to formulate its own investment requirements, this may create imbalance in two ways: (1) The investment plan of the firm may not coincide with the planned development of the national economy as determined by the planners. (2) In view of the scarcity of investment goods under the plan, each firm may not be able to obtain the necessary resources to achieve its own investment plan. Briefly, a course of action which might be quite possible for a single firm is not necessarily possible when expanded, in the context of a central plan, to all firms in the economy.

Given the structure of the Soviet price system, imbalance also might occur in the consumer goods section if firms exercise autonomy in determining their respective wage and labor requirements. This practice would remove from the central planners their control over the income released into the hands of consumers. In the absence of such central control over the source of disposable income, imbalance in this sector could result in inflationary pressures on prices, if such a phenomenon can be conceived in a Soviet type system, or at the very least, imbalance at the micro-level in the form of shortages and surpluses of specific goods in the total market.

Additionally, imbalance might occur in the labor market relative to the total supply and demand for labor at established wage scales and the allocation of the labor force. Given the fixed supply of labor, if firms

could draw up their own demands for labor, it is possible that demand could exceed supply in the national labor market in specific areas of industries and in certain categories of labor. With wage rates fixed by planners, excessive demands of certain types of highly desired labor would result in a shortage of this type of labor with no means such as flexible wages or central allocation to resolve the shortage.

Balance among these various sectors is traditionally attempted in the Soviet economy by central planning of the pertinent indices. However, in Liberman's proposal, these indices will be left to the discretion of the firm and no mention is made in the Liberman proposals of the impact of profitability criterion on either materials-allocation, the price system, or the maintenance of financial balance. The fact that the Liberman proposals avoid the problem of integrating the autonomy of enterprise activity and the use of the profitability criterion with the activities of planners on the national level limits to a considerable degree the partial requirement of balance and coordination as a part of achieving rationality. Unless an integration of the activity of the firm with the planned totality of economic activity can be provided, the implementation of Liberman's suggestions may cause serious imbalance at the macro-level. Liberman, himself, indicated that his primary concern was the individual enterprise, and his proposals apply rather well in reducing the problems encountered by the firm. This is a step in the right direction, but the proposals do not explain how, at the national level, the decisions of the planners will turn out to coincide with the independently-made decisions of semi-autonomous enterprises.

This evaluation with reference to balance and coordination does not complete the investigation of Liberman's proposals relative to rationality.

Rationality requires efficiency as well as balance and coordination. Liberman's emphasis on profitability as the key index in his proposals necessitates the consideration of the meaning of profit in a Soviet-type system.

Profit acts in a free market as an indicator of efficiency. The existence of profit serves to guide resources to their most efficient use. Resources are considered to be used most efficiently when they yield a maximum return relative to economic cost in relation to the sacrifice of the next best alternative use to which the resource could be put. Therefore, given the cost of resources and the product prices, the most efficient use of resources will create the greatest value product at the least cost and consequently, result in the most profit.[2]

The existence of profit also provides producers with the incentive to produce goods which are in greatest demand by consumers.[3] In the short-run, given a system of scarcity prices and a fixed supply of a particular good, consumers will express their valuation of each good by the price they are willing to pay for it. Obviously, under these conditions, those goods upon which consumers place the greatest valuation will command the highest prices, and producers of these goods will receive the greatest relative incomes. Assuming this income received by producers relative to their costs is large enough to create a pure economic profit in the short-run, the existence of the pure profit serves as a signal to producers that more of the good is wanted by society. In the long-run, producers will tend to expand production of the goods which

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[2]In speaking of the existence of profit, the writer is assuming a price and cost structure of such a nature that profit is created.

[3]The term "goods" in this discussion refers to either intermediate or final goods.

yield a profit, and this, obviously enough, will increase the supply of the goods upon which consumers place the greatest valuation. Consequently, this efficient allocation of resources will create the greatest consumer satisfaction.

This discussion indicates the economic significance of profit and the relationship of profit to rationality via the effect of profit in guiding resources into their most efficient uses. But, is this significance the same under a market price-directed system and a system of planned prices? This is the crucial question which must be considered in an evaluation of the Liberman proposals.

The economic significance of profit in a Soviet type economy differs from that which prevails under a market price system. As indicated in Chapter I, Soviet prices are fixed by the central planners for relatively long periods of time and are set to reflect both costs of production and a predetermined structure of consumption. Prices serve as indices of control set by the planners to direct the activity of the economy toward predetermined goals. Thus, planned prices reflect the preferences and controls of the planning authority; whereas, market prices reflect the preferences of consumers and the scarcity of economic resources. Now the questions arises, how does this difference affect profit?

Profit will not direct resources to their most efficient use if the prices and costs upon which profitability calculations are made reflect the preferences of the planners rather than utility-cost relationships as expressed in the market. Profit under planned prices will direct resources to uses preferred by the planners, whether these uses are the most efficient or not. This allocation of resources in the direction of the preferences of the central planners is reinforced by the Soviet

system of materials-allocation. In cases involving the allocation of a resource considered oritically by the planners, profit will have no effect on the allocation; the allocation will be made by the planners to facilitate the fulfillment of a predetermined objective. Even if planners attempted to set prices to duplicate the operation of a market system, their task would be veritably impossible as a result of the imperfectness of their knowledge, the complexity and interdependence of economic activity, and the physical administration of prices requiring frequent changes.

So we can see that under a system of planned prices, profit is not a very reliable indicator of efficient use of resources. But efficient allocation of resources is not the only function of profit under a market-directed price system. Profit also provides the incentive for producers to produce goods, either intermediate or final, upon which customers place the greatest valuation. In providing producers with an incentive to produce goods upon which the consumer places the highest valuation, profit under planned prices again falls short of profit under a market-directed price system.

Profit calculations based on planned prices reflect the preferences of the planners and not the consumer. If a particular firm or industry shows a high profitability, more resources will not automatically move into that particular type of production. Resources will move into this area only if they are so directed as part of a centrally designed investment plan. In short, free entry and exit as associated with a market system does not exist for socialized units of production in a Soviet type economy.

Profit under planned prices does not necessarily reflect a high consumer valuation on that product relative to alternatives that must be given up. The high price causing the profit may merely be set at this high level to ration a particular commodity which is in short supply because the planners do not want its production increased.

In view of this restricted role of profits under a planned price system, the question comes to mind, why did Liberman choose profitability as his key index? Liberman was primarily interested in improving incentives and planning at the firm level; so he tied the incentive fund to the profitability index which would be computed for groups of similar firms and based on both current and fixed assets. Even though centrally administered prices and materials-allocation prevent profitability from assuming the role it does in a market economy, it still could provide an incentive at the individual firm level.

The autonomy Liberman suggests for the firm in drawing up its own plan except for the profitability index and amount and composition of output and the freedom in the use of the incentive fund does increase the motivation of the individual firm director to strive for greater efficiency in his own production and decreases his desire to understate his output potential. Additionally, Liberman's profitability index is a first step toward introducing a charge for invested capitals into the cost calculations of the firm and suggests a basis for a more efficient allocation of capital resources rather than the present more or less arbitrary method of central allocation of investment. These, then, are the effects on efficiency contained in the Liberman proposals.

Perhaps the greatest impact of the Liberman proposals is revealed by the fact that their publication brought forth open discussion of the

Soviet planning system and its improvement. Whether the ensuing discussion was against the proposals, for them, or for their modification, economic controversy was stimulated. Even the conservative planners had to think in order to defend their system from this liberal suggestion for reform. But most important of all, the proposals directed attention to the concepts of capital investment and profits and to the Soviet systems of pricing and allocating materials, and this, if nothing else, is a step in the right direction. In short, Liberman's proposals greatly stimulated Soviet economic thought.

According to Campbell, the suggestion of E. G. Liberman that an enterprise should be freed from "petty tutelage" by higher level bureaucrats and judged only by its profit results elicited so favorable a response from managers that "Libermanism" has become an articulate and influential movement.[4] In his article on the Liberman proposals, A. Zverev, one of the chief opponents of the suggested reforms states that:

> The questions posed by Liberman have attracted widespread attention and sparked a lively discussion of many vital problems. Undoubtedly this will considerably accelerate the search for, and elaboration of, the best methods of material incentives.[5]

Most of the authors contributing to the Liberman discussion made similar statements regarding the necessity for further study in improving planning and the material incentive system. Kasitskii suggests a series of two stages in achieving the solution of the problems surrounding planning and incentives: First, the criteria for planning premiums and indices for enterprises must be settled, and these criteria tested through a

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[4] Campbell, p. 169.

[5] Zverev, p. 16.

system of economic experiments in different branches of the economy. Then, from the results of this experimentation, concrete proposals of reform could be formulated.[6]

In addition to the stimulation of discussion in search of methods by which to improve Soviet planning, the Liberman proposals have had a partial effect at the operational level of the economy. This impact is reflected in the guarded effort of Soviet planners to experiment with "libermanist" type reforms on a small scale in the economy. In July, 1964, an experiment was attempted in decentralized control at two large clothing plants - the Bolshevichka plant in Moscow and the Mayak plant in Gorky.[7] Briefly, the experiment allowed the establishment of profitability as the main indicator for evaluating the success of the firm, for rewarding the managers, and the use of direct contracts between producers and retailers as the basis for planning and scheduling production. The central authorities maintained control over prices, major capital investments, sales, and profitability targets.

After one year of operation, the experiment was considered a success when results showed that the key indicators of output, profit, and profitability at both the firms were above the pre-test levels.[8] The experiment was then extended to 400 firms in the apparel, textile, and leather industries.[9] While the expansion of the initial experiments was

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[6]Kasitskii, p. 15.

[7]Imogene Eno, "Economic Reform in the Soviet Consumer Industries," New Directions in the Soviet Economy, Part II-B, Studies Prepared for the Subcommittee on Foreign Economic Policy of the Joint Economic Committee, Congress of the U. S., (Washington, D.C., U. S. Government Priting Office, 1966), p. 558.

[8]Ibid., p. 559.

[9]Campbell, p. 93.

being carried out, Premier Kosygin laid the groundwork for a major reform of all Soviet industry in a speech before the central committee of the Communist Party of the USSR.[10] This reform eliminated the traditional emphasis on gross output as an indicator and emphasized the role of profits, bonuses, and the value of sales along with recommendation for direct contracting among firms and for levying an interest charge on invested capital.[11]

These reforms are the first steps toward improving the traditional system of Soviet planning, but at the same time should not be construed to inaugurate the formation of a "free market" type system in the Soviet Union. As such reforms are gradually implemented and further applied to the actual operations of Soviet industry, their success will depend in a large measure on such factors as the significance of Soviet prices, the adequacy of incentives, and the availability of the necessary equipment and materials.[12] The various degrees of success and failure associated with these and further reforms will provide much data for further study in the problems faced by a planned, Soviet-type economy and for analysis of the possible solutions to such problems.

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[10] Eno, p. 564.

[11] Ibid.

[12] Gregory Grossman, Economic Systems, (Englewood Cliffs, New Jersey, Prentice-Hall, Inc., 1967), p. 96.

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APPENDIX A

STRUCTURE OF THE SOVIET PLANNING INSTITUTION*

COMMUNIST PARTY ORGANS		GOSBANK & STATISTICAL AGENCIES
	USSR Government	
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	*	
	Supreme Council of National Economy	
	*	
	Gosplan USSR *	
	Gosplan USSR Sovnarkhoz	
	*	
	*	
	Big Planning Regions	
	*	
	*	
	Republican Governments	
	*	
	*	
	Republican Gosplans	
	*	
	*	
	Sovnarkhozy	
	*	
	*	
	Local Authority-Oblast	
	*	
	*	
	Sector Departments	
	*	
	*	
	Union-Republican & Local Enterprises	

*Source: Alec Nove, p. 73.

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