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Vladimir Kontorovich

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BOOK REVIEWS

What is To Be Done? Proposals for the Soviet Transition to the Market, Merton J. Peck and Thomas J. Richardson, editors, New Haven and London: Yale University Press, 1991.

*Vladimir Kontorovich**

This book is the result of a study commissioned by a Soviet government agency which sought the advice of Western economists on transforming the Soviet economy along market lines. The project involved several conferences sponsored by the International Institute for Applied Systems Analysis in 1990, attended by Western, East European, and Soviet economists. Not all of the project's recommendations were followed in the Russian transition to market that started in January 1992. Yet the project must have influenced its Soviet participants, who later became the top members of the Russian cabinet and the architects of the current transition strategy.

The introductory chapter, written by the editors, recounts the history of the project, analyzes the state of the Soviet economy in 1990, and highlights the main proposals for transition. Chapter 2 is a condensed version of the reform proposals. It was presented as a memorandum to Soviet President Gorbachev at the end of 1990. The following five chapters are written by the chairmen of the study groups at the 1990 conference and deal with particular aspects of transition. Chapter 3, by Merton Peck and Alfred Kahn, discusses the establishment of a market: setting off the price mechanism, making producers behave as profit maximizers, and promoting competition. Subsequent chapters deal with macroeconomic stabilization (William Nordhaus), external economic relations (Richard Cooper), moderating the social costs of unemployment (Wil Albeda), and privatizing and creating a commercial banking system (Kimio Uno). An appendix to the book, by Petr Aven, chronicles Soviet economic developments since the mid-1980s.

The book stresses the interconnected nature of the elements of a

* Assistant Professor, Economics Department, Haverford College

market economy, such as prices set by supply and demand, private ownership, well-organized capital markets, internal and foreign competition, and sound money.¹ All these components must be present for a market economy to work efficiently. From this indisputable proposition follows the book's central recommendation. The main elements of the market economy have to be introduced simultaneously. Prices should be liberalized, enterprises converted into managerially and financially autonomous entities, government spending stabilized and credit restricted, social costs of unemployed moderated, and the economy opened to both internal and international competition — all at the same time.²

If this list exhausts the elements necessary for smooth functioning of a market economy, and all of these elements can indeed be put into place simultaneously, then the problem of transition to market is resolved. The enactment of a carefully drafted legislation creates a market economy, a world in which profit-maximizing producers, respond to price signals in the ways familiar to Western economists. What is left to be done is the usual set of tasks of fiscal and monetary management, anti-trust and safety-net policies. In fact, there is no transition here, but rather a leap from command to market realm.

As it happens, the book's list of measures is incomplete. For example, a competent and honest government that would enforce the laws and regulate the economy is commonly considered a prerequisite for a modern market economy, which is especially relevant for the Soviet/Russian context. Relegating the creation of a housing market to a few lines is also an omission.³ More importantly, a complete list of conditions necessary for a smoothly functioning market can hardly ever be produced, for the same reason that complex hardware and software designs cannot be produced without bugs. The enactment of a comprehensive set of measures would not result in a workable market economy, but in a hybrid system with potentially surprising characteristics. Managing this hybrid and turning it into a workable market economy is what the transition is all about.

There is another problem with the book's prescription for a leap into market. Each of the necessary features of a market economy take different amounts of time to set up. For this reason, they cannot be implemented simultaneously. Thus, prices can be freed from administrative control practically by a stroke of a pen. Merton Peck and Alfred Kahn

¹ What Is To Be Done? Proposals for the Soviet Transition to the Market 41 - 42 (Merton J. Peck and Thomas J. Richardson eds., 1991)

² *Id.*, at 9.

³ *Id.*, at 141.

advocate just this course of action in their chapter. But for prices to work properly, producers should be maximizing profit. Such behavior would make sense if enterprises were privately owned. Yet “privatization is going to take time”, because there is no political agreement on how to distribute ownership.⁴ So the authors propose a substitute that would make producers respond to price signals as if they were profit maximizers even before privatization and could be enacted simultaneously with price decontrol.⁵ This substitute, called “corporatization,” would include converting state enterprises into joint-stock companies, enacting property and contract legislation, passing bankruptcy law, making credit available at market interest rates only and ending direct and disguised government subsidies. But this too, is going to take time.

With careful preparation, all the laws embodying the recommendations of the present volume can be passed simultaneously. But passing a law on property or bankruptcy and making it effective are not the same things. The former can be precisely timed; the latter takes time. We will leave aside the fact that the disagreements among the Russians on each of the elements of corporatization are as sharp as their disagreements on the issue of privatization (witness the parliamentary deadlock over the bankruptcy law earlier this year). Even if there is a consensus on the shape of some future institution, and the corresponding law is passed promptly, it will take time for this institution to start functioning. This time is needed for the qualified individuals to step forward and join the new institution; for them to learn their new roles — separately and in coordination with each other — and for the institution as a whole to learn to coexist with other actors in the economy.⁶

“What Is To Be Done?” is itself a good example of the fact that new projects take time to mature. It was initiated in the fall of 1989, the text was finished in the summer of 1991, and the book was published by the end of that year. It took some of the best American and Russian economists, a well-funded intergovernmental organization, and an established publishing house more than two years to complete this 220 page volume. The task of corporatization — setting tens of thousands of enterprises free of administrative control, and subjecting them to hard budget constraints is much more complex, and is likely to take much longer than producing the present book.

⁴ *Id.*, at 58-59.

⁵ *Id.*, at 38, 58.

⁶ See Vladimir Kontorovich, *Sovietskaia ekonomika v blizhaishiei perspektive*, 9 *Ekonomika i organizatsiia promyshlennogo proizvodstva* 145, 146 (1991). Similar points were advanced in discussion of the Soviet Shatalin plan (similar to the present book) in 1990.

The main prescription of the book — simultaneous enactment of all the elements of a market economy — is unfeasible, because the list of such elements is incomplete and some of those mentioned will take considerable time to implement. The elements that interact so neatly in a working market economy can only be introduced piecemeal into a market economy in the making. There will necessarily be a period when the transitional economy will have some market institutions but not others (because the latter were left out of the original design, or have not taken root yet). This means that market institutions that will be the first to appear in the transitional economy will not perform well.

Thus, there is no reason to believe that the managers of corporatized enterprises will be maximizing profits. The stock of the former state-owned enterprises will be held by the government — appointed property management agencies. These agencies will select enterprise directors who in turn will hire the managers. The government will instruct the agencies to maximize profits of subordinate enterprises, and the agencies will demand the same from their corporations.⁷ However, “maximize profit!” is not an enforceable command, as the reformers of centrally planned economies have discovered over the last thirty years. The authors propose to reinforce this command by compensating property management agencies and enterprises’ directors with ownership shares. While this is a real incentive, the temporary nature of the whole arrangement is likely to make strategies other than profit maximization attractive. The property management boards will likely be catering to the political needs of the government that appointed them. Enterprise managers, possibly in collusion with the property management agencies, will be positioning themselves to maximize their own gains in the coming privatization, lobbying or blackmailing the government for subsidies, or simply stripping their plants clean.

Independent producers who are not maximizing profits behave in rather unusual ways. In 1988-91, when Soviet enterprises were given some discretion over production decisions, they responded to higher prices by cutting output. They also preferred high cost inputs to low cost. This perverse behavior (negatively sloped supply curves and cost-maximization) continued during the transition of 1992.⁸ Of course, fiscal and monetary tightening was supposed to make such behavior unsustainable. Yet it was displayed on such a massive scale, that it instead made the planned stabilization policies unsustainable.

⁷ What Is To Be Done, *supra* note 1, at 61.

⁸ See, e.g., Sergei Glaziev, *Liberalizatsiia tsen nel'zia Nazvat'udachnoi*, *Nezavisimaia gazeta*, May 21, 1992, at 4 (analyzing Russian economic performance in early 1992).

The book differs from many other transition blueprints in its estimate of the plan's immediate costs. It is usually thought that a transitional economy, with a mix of old and new institutions as described above, cannot work well. This has been confirmed as early as 1990 by the experience of economic transformation in Poland. Decisive steps toward market caused output to plunge. Living standards declined, and unemployment increased. The present book states that its strategy, applied to the Soviet economy, will bring immediate gains by reversing the ongoing output decline. One reason for this claim, as discussed above, is that the book assumes away the difficulties of a transitional economy with its recommendation of a "leap" into a market economy.

The other reason for the promise of a painless transition can be found in the book's analysis of the causes of the economic contraction in 1990-91. "Output in the Soviet case is falling because consumer goods and industrial inputs are no longer reliably available for rubles The measures proposed here aim quickly to restore the internal convertibility of the ruble for domestic goods and services and thus to permit real output to return to its 1989 level".⁹ This cannot be a slip of the pen, since elsewhere, the "return to an effectively functioning money economy" is mentioned and the breakdown in interregional flow of goods is explained by the decreasing reliance on the ruble as a medium of exchange.¹⁰ This is a serious misconception about the nature of the Soviet economy.

Practically all producer and many consumer goods have not been reliably or otherwise available for rubles for the last sixty years. They were distributed by the government and Communist party officials in accordance with the national plan. This "allocation of resources by command" was the defining feature of the Soviet system. The Soviet economy has been contracting since 1990 (if not 1989) because the mechanism for channeling supplies was first impaired, then decimated, by Gorbachev's reforms.¹¹ Talk of restoring the internal convertibility of the ruble and the effectively functioning money economy suggests a Latin American or post-war European country that has been ravaged by hyperinflation. The role of money as a medium of exchange can be restored in this case rather quickly by a set of monetary and fiscal measures because all the capitalist institutions already exist. In Russia these institutions have to be created anew.

When communist regimes started to topple in Eastern Europe, no

⁹ What Is To Be Done, *supra* note 1, at 16.

¹⁰ *Id.*, at 43 and 55.

¹¹ See *The Disintegration of the Soviet Economic System* 23, 24 (Michael Ellman and Vladimir Kontorovich eds., 1992).

literature on the economics of transition to capitalism existed. Yet the discipline of economics responded to the new demand exactly the way it would have predicted. Economists switched from other fields to the study of transition and at least a dozen books and symposia in journals devoted to this topic have appeared in just two or three years. Of course, little new knowledge can be created in such a short time. What one can hope for is the thorough application of the existing knowledge to a new problem.

Charting the transition from command economy to a capitalist one requires the knowledge of the point of departure, the destination point, and the terrain between the two. The authors of this book are the experts on the destination point, the workings of a capitalist economy. This is also by far the strongest area of economics, since it has been studied for hundreds of years. The book does an admirable job summarizing this knowledge for the benefit of the Soviet reformers. The authors tried to familiarize themselves with the point of departure, but have succeeded in their endeavor only partially. The study of centrally planned economies was a tiny and relatively young field. Much of the knowledge it has accumulated has not been translated into the analytic language common to other fields of economics. This knowledge exists in the shape of lengthy institutional descriptions that take time to assimilate. Even drawing on such authoritative sources like John Le Carre's *The Russia House* left the authors of the book with a weak grasp of the nature of the system they are proposing to overhaul.¹²

The students of centrally planned economies have also learned some potentially useful things about the third element in the theoretical transition map, the terrain between socialism and capitalism. Over the last thirty years, there have been numerous half-hearted attempts to reform these economies along market lines. The great distance between enacting a law and changing the economy, the impossibility of effectively mandating objectives of economic actors and the inevitability of flaws in any comprehensive organizational redesign are among the relevant lessons of these failures. These are all negative lessons. Economists have little positive to say on the subject. Transition is about the emergence and development of market institutions. And until very recently, economists have been taking the institutions of market economy for granted.¹³

The lack of a good map does not mean travel is impossible. It just takes longer and costs more, and there is a risk of getting in the wrong

¹² What Is To Be Done, *supra* note 1, at 2.

¹³ As Ronald Coase has argued in his Nobel Prize speech. See Ronald Coase, *The Institutional Structure of Production*, 82 Am. Econ. Rev. 713, 714 (Sept. 1992).

place. Poland and Hungary may now have weathered the worst part of the transition. But these were the two cases that were expected beforehand to be the easiest. Economies of the former Soviet Union will have a more difficult time with trial and error transition. They might even turn back. Still, one hopes they will complete their journey sooner than it takes the economists to come up with a decent map.