

# **The Carl Beck Papers**

## **in Russian and East European Studies**

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No. 805

### **Soviet Economic Law: The Paradox of Perestroyka**

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June 1990

ISSN 0889-275X

*The Carl Beck Papers:*

Editors: William Chase, Bob Donnorummo, Ronald Linden

Assistant Editor: Mitchell Bjerke

Design and Layout: Robert Supansic

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*But it was also clear that an all-round increase in wealth threatened the destruction — indeed, in some sense was the destruction — of a hierarchical society. In a world in which everyone worked short hours, had enough to eat, lived in a house with a bathroom and a refrigerator, and possessed a motorcar or even an airplane, the most obvious and perhaps the most important form of inequality would already have disappeared. . . Goods must be produced, but they must not be distributed. And in practice the only way of achieving this was by continuous warfare. . . . The social atmosphere is that of a besieged city, where the possession of a lump of horseflesh makes the difference between wealth and poverty. And at the same time the consciousness of being at war, and therefore in danger, makes the handing-over of all power to a small caste seem the natural, unavoidable condition of survival.*

— George Orwell, 1984

*There is a sense in which the leaders of the Soviet Union are monopolists; but complete hierarchical control is beyond their means. And, whether decentralization is deliberate or ineluctable, it leads to many of the same problems we impute to the profit motive in the private sector in this country.*

— Thomas C. Schelling, *Choice and Consequence*

The current Soviet leadership wishes to transform the world's largest centrally managed economy. It hopes through the *perestroika* (reconstruction) campaign to diminish the economic bureaucracy, to create markets for production inputs and consumer goods and services, and to expand the role of primary production units, including private firms. Because it also seeks to supplant the present environment of administrative fiat with a developed legal culture, the leadership has memorialized these aspirations in the form of legal mandates issued by the appropriate organs of state authority.

The enacted and proposed changes in Soviet economic law have captured the attention of the West.<sup>1</sup> Accompanied as it has been by the *glasnost*' (openness) program, which has made Soviet policy debates more accessible and attractive to westerners, the prospective transformation of the economy has led many to hope that convergence will out, that the nation which for so long we have feared and guarded against will become like us. Apologists for markets and democratic pluralism also sense a great ideological victory in the making, as the country that for most of this century has offered itself as the principal adversary of the capitalist system seems close to conceding defeat.

A deeper look at *perestroyka*, however, suggests puzzles, not a clear-cut morality play pitting Western values against Soviet blunders. Developments in Soviet economic law in particular present two paradoxes. Almost all analysis of Soviet politics and government has rested on the assumption that a small and self-perpetuating clique pursues its own interests at the expense of the general welfare.<sup>2</sup> Yet *perestroyka*'s efforts to transform a command economy themselves reflect commands from the highest political echelon. Not only does top leadership demand decentralization, confounding the traditional notion of the center as self-interested, but the process of implementing decentralization perpetrates a system of orders from above rather than of initiative from below. Why are the Soviet leaders, in particular General Secretary M.S. Gorbachev, seeking to give away their power? If they succeed, what forces will remain to sustain economic decentralization?

A way out of this paradox is to reject the traditional wisdom and to argue that Gorbachev and his colleagues are not autonomous, much less omnipotent. Instead, the leadership's efforts to promote economic decentralization might reflect the demands of lower-echelon managers and bureaucrats.<sup>3</sup> But this argument leads to a second paradox. Mounting evidence indicates that these groups— enterprise directors, regional and district-level party leaders, and the like— have dragged their feet on decentralization. Why do the intended beneficiaries of *perestroyka* resist?

a military hierarchy, with vertical lines of command constituting the significant legal relationships and horizontal rights among producers fading into insignificance. Central management, expressed through the central planning system, bound together the many components of this command economy.

The Politburo of the Party's Central Committee, and ultimately Stalin alone, occupied the pinnacle of the Soviet economy's organization chart. Immediately below the Politburo were the Party Secretariat and the Council of People's Commissars (*Sovnarkom*, later the Council of Ministers), in turn subdivided into the economic departments of the Party Secretariat and the separate People's Commissariats (later the Ministries). In addition to these sectoral units, which managed particular product groups or economic sectors on a nationwide basis, the Party, reflecting the structure of the Soviet state, also contained territorial divisions. Party organizations existed for every Republic except the Russian Socialist Federated Soviet Republic (RSFSR), the largest territorial unit and the homeland of the dominant Russian majority. Within the RSFSR and the other republics the Party structure mirrored the state organization. Each region (*oblast'*), territory (*kray*), autonomous republic, autonomous *oblast'*, district (*rayon*), and national area (*okrug*) had a party committee, with the first secretary of each representing the highest political authority within that territorial unit.<sup>8</sup>

At the heart of the central management apparatus was *Gosplan*, the State Planning Committee attached to the *Sovnarkom*. The government had created *Gosplan* in the early 1920s, but only in 1934, at the start of the second Five Year Plan, did it fully realize its crucial role in managing the national economy.<sup>9</sup> Once collectivization and the first Five Year Plan had liquidated the remnant private economy, all production units depended on *Gosplan* for both their production targets, expressed in gross quantitative terms, and their inputs. The commissariats would negotiate with *Gosplan* over each, typically to lower the targets and to increase the inputs. But *Gosplan*'s policy of "tautness"— *i.e.*, insisting on strict matching of input

and product— complicated these negotiations. Producers that consumed intermediate goods had no leeway with respect to their inputs— the *Gosplan* allocation assumed that the producers of these goods met their own ambitious production targets.<sup>10</sup>

Within the industrial sector, each commissariat doled out responsibilities for particular products among main administrations (*glavki*). The *glavk*, centered in Moscow (or, for republic commissariats, the republic capital), would administer the basic production units— the enterprise (*pyedpriyatiye*). Agriculture followed a similar pattern, although the basic unit was either the state-owned state farm (*sovkhoz*) or the state-regulated collective farm (*kolkhoz*). Within each unit, the fundamental management principles were one-man management (*yedinonachaliye*) and economic accountability (*khozraschyot*). These meant that the local enterprise manager or collective farm chairman had full authority within the production unit itself, and that the enterprise had to fund its inputs through sale proceeds plus withdrawals from its capital.<sup>11</sup> The *glavki* and commissariats, by contrast, would receive appropriations from the state budget to fund their activities and would turn over profits received from enterprises to the state.

These fundamental elements of the Soviet economy have remained fairly stable up to the present. Some minor changes did occur even during Stalin's lifetime. In 1946 the government transferred *Gosplan's* authority to allocate inputs to a new entity, the State Committee for Material Supply (*Gossnab*). At the same time Stalin, in a tacit recognition of the national and personal, as opposed to revolutionary and communist, nature of his regime, discarded the terms commissars and commissariats in favor of the more traditional ministers and ministries. But the main elements of Stalinist administration continued invariant.<sup>12</sup>

## Functioning of the Stalinist System

To understand how these different elements interact in a functioning administrative system, one must keep in mind the four basic characteristics of the Stalinist economy: state ownership of the means of production; enterprise performance evaluated in terms of gross quantitative output targets; fixed prices bearing no relation to market forces; and a centralized hierarchical administrative apparatus. These characteristics are interdependent. State ownership means the elimination of markets that might set prices. Because markets do not set prices, profit is a useless criterion for evaluating performance. Instead, a central administrative apparatus must impose quantitative criteria to constrain managers from shifting production toward goods with the highest sale price.<sup>13</sup>

A Soviet enterprise manager operates under an annual program involving both supplies and production. The annual targets reflect the overall ambitions of the Five Year Plan, which in turn flow more from the political goals of the Party leadership than from the desire to increase production and raise living standards. In theory, the targets are knowable and fixed, but an ongoing renegotiation process makes them obscure and contingent. The enterprise manager bargains with the *glavk* that administers his operation for the best possible mix of inputs and production targets; the *glavk* represents him in the Ministry, which in turn deals with *Gosplan*. At the end of this round of bartering *Gosplan* determines the overall state output for that year, which allows it to tell *Gossnab* what the supply of necessary inputs will be.

After further negotiations with the Ministry, *Gossnab* issues an order (*naryad*) informing the enterprise how much of its desired inputs it may obtain and what enterprise must provide them. Price is fixed, but the two enterprises may bargain over terms such as delivery, assortment, terms of payment, and the like. If they cannot agree, the state arbitration panel attached to the Council of Ministers (*Gosarbitrazh*) writes a contract for them.<sup>14</sup>

The enterprise has monthly and quarterly output targets for plan fulfillment, but the real reckoning comes at the end of the year. Historically, the principal criterion for evaluating the manager's performance has been how well he met the production target, stated in gross quantitative terms. Underfulfillment would result in lost bonuses and, in extreme cases, dismissal, while overfulfillment would create problems for the ministry by giving *Gosplan* an excuse to raise future production targets. Secondary conditions such as profitability have had no impact on the manager's career, in spite of the implications of *khozraschyot*. Because the prices of inputs and outputs do not reflect demand or scarcity, a comparison of sale proceeds to input costs is meaningless. Instead, enterprises that generated more rubles than they consumed have had to turn over their profits, less only an allowance for additions to capital, to the *glavk*, while losing enterprises received subsidies from the ministry as long as they continued to meet their production targets.<sup>15</sup>

To operate successfully, an enterprise must do more than please its Ministry and *Gosplan*. Many essential inputs, particularly those relating to the workforce (housing, schools, and other social services) depend on cooperation with the local political authorities. The *oblast'* or *rayon* party committee has ultimate responsibility for these resources, and enjoys sufficient discretion over their allocation to possess life-or-death power over enterprises.<sup>16</sup>

Pervasive secrecy, a crucial aspect of the Stalinist system of administration, has complicated all of these relations. The ethos of concealment had several sources— a holdover from Tsarist culture, the desire to reinforce political domination by depriving the masses of the ability to anticipate events, and paranoia among members of the unstable new elite. Secrecy, already great during the 1920s under a revolutionary regime that monopolized all sources of public information, expanded terrifically as a result of the inflated claims of the first Five Year Plan and the carnage wrought by collectivization of the peasantry. It became necessary both to suppress



news that contradicted the regime's boasts of success and to conceal the millions of deaths that accompanied industrialization.

Information scarcity also reinforces status in the administrative hierarchy. Access grows in direct relation to the bureaucrat's removal from actual production. Only at the highest levels— in the Politburo and the Secretariat of the Party Central Committee— has the right to demand access breached departmental lines. But few people serve in this echelon and they have difficulty organizing this information into manageable form.

With respect to economic administration, secrecy entails much more than keeping the general public in the dark. The Stalinist system compartmentalizes all economic information.<sup>17</sup> Managers tell the Ministry only what they must, Ministries give *Gosplan* minimal information, and no Ministry shares information with any other.<sup>18</sup> This compartmentalization operates at cross purposes to the status-reinforcing function, as the quality of information degrades with each bureaucratic layer (and corresponding departmental filter) through which it passes.

In extreme cases the criminal law enforcement organs— primarily the secret police (at various times the NKVD, MVD, and most recently the KGB) but also the economic police (BKhSS) within the Ministry of Internal Affairs— can investigate particular enterprises. But those organs exercise this power sporadically, and always under the control of the top echelon. Monitors that generate information about economic performance in the West, particularly capital markets and an independent press, have no Soviet counterparts.

### **The Pathology of the Stalinist System**

As a strategy for economic administration, the Stalinist system has two serious defects. The first and most widely noted is poor performance. Through the 1960s new sources of raw materials and urbanization-driven growth in the workforce masked how little the industrial and agricultural sectors produced as a function of what they consumed. But since the early

1970s production has declined in terms of both gross output and, more ominously, technological sophistication.<sup>19</sup> The proponents of *perestroika* blame the deterioration on the Stalinist system, which they characterize as representing an “extensive” form of economic development. They call for a conversion to “intensive” development based on better labor productivity and technology.<sup>20</sup>

Another, less-heralded defect of the Stalinist system is its capacity for encouraging particularist interests at the expense of the central leadership. Although both Western and Soviet observers employ the term *nomenklatura* to refer to a single ruling class, in reality members of the Soviet elite have divergent interests based on differing lines of authority and functional responsibility. The Soviet terms for the centrifugal forces that developed under Stalinism are departmentalism (*vyedomstvyennost'*), meaning the pursuit of sectoral/ministerial goals, and localism (*myestnichyestvo*), meaning the elevation of regional/territorial interests. Behind these terms lies a significant political insight — the top leaders (a group that, for heuristic purposes, I will assume to comprise the members of the Politburo, and their immediate staff, including most of the bureaucrats in the Central Committee's Secretariat, and to a certain extent economic agencies such as *Gosplan* that have responsibilities that cut across departmental and regional lines) confront a balky, occasionally hostile middle-echelon of bureaucrats (a group that probably comprises many heads of national and republic ministries, *oblast'* Party first secretaries, and the bureaucrats who report to these figures).<sup>21</sup> Every Soviet reform program from the Khrushchev period to the present has attacked the twin evils of departmental and local independence.

More recently, competition among elements of the middle-tier bureaucracy has enabled low-level actors — enterprise directors and even average workers and consumers — to achieve some political and economic independence, largely through their participation in an expanding underground economy. In some cases active figures in the second, or shadow, economy have enjoyed higher incomes and have wielded greater

power than members of the *nomenklatura*'s inner circle. Although the development of the second economy has compensated for some of the production shortcomings in the legal, state-owned economy, it also directly threatens the fundamental premise of the Stalinist system, namely the elite's monopoly over the distribution of scarce goods. This threat has provoked increasingly radical responses by the leadership.

### **A Theory of Failure in the Stalinist System**

Western work on the economics of organizations provides the tools for a theory that can explain the failure of the Stalinist administrative system and the emergence of alternative organizational forms under Gorbachev. This work analyzes cooperative economic activity in terms of its goals. In particular analysts have focused on the costs that result from participants in an enterprise facing incentives that vary with their particular organizational responsibilities. One of the main tasks of this literature is to explore how different organizational forms, and the legal rules that implement them, can affect these costs.<sup>22</sup>

What I will call an agency-costs analysis— that is, studying an enterprise in terms of the costs associated with particular forms of organization— has obvious relevance to the Soviet economy, the world's largest single economic organization. Western scholars previously have used this methodology to explain the system's poor production performance. My objective is to extend that explanation to account for the system's failure as a mechanism for political domination. So extended, the analysis provides a tentative solution to the paradox presented by Gorbachev's reforms, *i.e.*, a campaign of decentralization promoted by the center and resisted by the periphery.

## Poor Performance and Agency Costs.

The emerging consensus among Western observers and Soviet proponents of *perestroyka* attributes low growth rates to the failure of the Soviet economy to assimilate and implement new technologies and production methods. In particular extremely long production runs for products, the low investment in new plant capital, rigid prices that fail to reward innovators, and personnel policies that punish the inventive suppress technological growth and other forms of innovation.<sup>23</sup> Until recently Western analysts had not developed a satisfying explanation for why the elite pursued these practices that deter innovation.

By using an agency-costs analysis, John Moore persuasively tied the seemingly irrational industrial methods to the political imperative of bolstering centralized control through limiting the discretion of enterprise managers. He demonstrated that long production runs, rigid prices, and hostility to new products serve as a bonding mechanism that reduce the agency costs connected to the relationship between enterprise managers and Moscow bureaucrats.<sup>24</sup> He drew an analogy between these practices and the accounting rules used by capitalist corporations, which by their standardization simplify the task of monitoring managerial performance. Similarly, the suppression of innovation limits the ability of managers to deviate from the plan targets generated by prior years' performance and thereby to escape from centralized supervision.

Soon after publication Moore's analysis gained support from emigre scholars who had worked on the Soviet economy. Both Olimpiad Ioffe, the foremost Soviet civil law specialist before his emigration, and Fyodor Kushnirsky, a former *Gosplan* economist, gave detailed accounts of how the Stalinist administrative system acts as a mechanism of political control.<sup>25</sup> They also argued that innovation and other means of improving performance conflict with the control objective, and that the Soviet leadership can attain better performance only by surrendering their power over decision making at the production unit level.

## Agency Costs and Autarky

Although Moore substantially advanced our understanding of the underlying reasons for the Soviet economy's poor performance, his analysis is incomplete. He did not develop a full model of the Soviet political system, but rather relied on the strong assumption that the elite has coherent objectives that it pursues monolithically. He analyzed agency costs stemming from the bilateral relationship between the elite and firms, and disregarded trilateral exchanges among the central leadership, intermediate elites that have formed autarkic coalitions, and the firms.<sup>26</sup> In an earlier paper I noted the possibility that the outcomes predicted by the agency-costs analysis might change if one accounted for competition within the *nomenklatura*, but I did not elaborate.<sup>27</sup> In this section I will adapt Moore's agency-costs analysis to a heterogenous *nomenklatura* and the trilateral relationships that result. In the remainder of this paper I will illustrate the comparative strength of this approach as a positive theory of Soviet economic law.

The Stalinist system generates incentives for both the enterprises and the sectoral bureaucracies to act independently of the whole. It rewards hoarders by evaluating performance on the basis of gross output rather than return on investment, thus encouraging producers to commandeer as much and many inputs as possible. It punishes altruistic producers— i.e., those that both produce to their maximum capacity and reveal this fact to higher levels of the administrative apparatus— by appropriating the product and raising production targets.<sup>28</sup>

The administrative apparatus does what it can to suppress hoarding and underproduction. But the system's commitment to secrecy frustrates these efforts. By hiding and distorting information, coalitions within the bureaucracy as well as individual production units promote their independence from the central bureaucracy. As the highest levels become more poorly informed, effective decision making authority (including the

authority to collect rents in the form of tribute and other kinds of privilege) devolves down the hierarchy.<sup>29</sup>

For anything but petty theft, the escape from central supervision entails coalition-building.<sup>30</sup> Concealment of information from higher authorities requires the complicity of everyone with access to that information, including the monitoring agencies such as the police. In the Soviet case the branch and territorial units— the ministry and the *oblast'*— became natural bases for such coalitions, reflecting the Stalinist pattern for compartmentalizing information.<sup>31</sup> In other words, *vedomstvennost'* and *mestnichestvo* grow when the central apparatus weakens its monitoring function.

By itself, this process does not threaten the Soviet system. Moore's premise, confirmed by Ioffe and Kushnirsky, is that the leadership's primary objective is maximization of the *nomenklatura's* control over the economy. This oligarchy seeks to maximize the power of its members as a totality, not on an individual basis. Augmentation of one oligarch's authority at the expense of another does not conflict with this objective. The losses suffered by the central leadership in favor of the ministerial and *oblast'* coalitions have welfare, as opposed to distributional, implications only if the devolution makes it more difficult for the *nomenklatura* to assert control over economic actors who are not considered to be part of the elite. In sum, *vedomstvennost'* and *mestnichestvo* raise agency costs only if they result in less efficient control over non-elite actors.

### **Agency Costs and Enterprise Autonomy in Light of Autarky**

Nonetheless, the growth of *vedomstvennost'* and *mestnichestvo* has raised agency costs in the Stalinist system. To understand how this happened, one must consider the opportunities members of the *nomenklatura* have to cheat on each other. Devolution of power— a transformation of a political monopoly into an oligopoly, with branch and territorial units sharing power with the central organs— has created the conditions for

intra-oligopoly competition to the benefit of actors at the bottom rung of the economic hierarchy— in the case of industrial management, the enterprise manager. The ministerial bureaucracy, the *oblast'* party hierarchy, and the central organs, including the police, now must bid for the enterprise's cooperation, each striving to offer the best mixture of incentives and penalties for the manager's loyalty. To the extent the manager can cooperate with one faction without tipping off the others, he can divert resources (including freedom to shirk) to his enterprise at the expense of the administrative hierarchy above him.<sup>32</sup>

An analogy to the problem of cartel maintenance may clarify the dynamic. One can view the Soviet *nomenklatura* as a kind of cartel, set up to maximize its members' economic power by limiting the supply of discretionary decision making exercised at the production-unit level. Following though on the analogy, allowing producers to evade central supervision in return for some sort of pay-off— e.g., bribes or other displays of loyalty— would constitute chiseling.

Economic literature suggests that cartel instability— that is, the incidence of chiseling by members— grows as noncompliance with the cartel rules becomes more difficult to detect.<sup>33</sup> In the case of the *nomenklatura*, middle-level members of the cartel (*i.e.*, ministerial and regional coalitions) face a reduced risk of detection when compartmentalization of information coincides with consistently overambitious production targets. The overambitious targets, by making disappointment inevitable, give these bureaucrats the opportunity to explain away an enterprise's failures, and secrecy makes it difficult for higher-level supervisors to distinguish authentic from contrived explanations. Under these conditions, it becomes easier for enterprises to strike side deals that relieve them from the rigors of centralized supervision. In extreme cases, enterprises might even achieve a kind of entrepreneurial Bonapartism, as the competing bureaucracies neutralize each other and thereby free the firm from subordination.<sup>34</sup>

In sum, agency-costs analysis predicts the emergence of two problems with the Stalinist administrative system. First, the system will profligately consume resources in relation to the output it produces, and discourage the development of technological innovations that could improve its productivity. Second, the system induces evasion of central administration. Initially it creates incentives for a devolution of power within the *nomenklatura* from the highest level of the administrative apparatus to the separate branch and territorial units. As this process progresses, enterprises and their employees begin to develop independence at the expense of the supervisory apparatus. This latter development, because it involves a net loss of the *nomenklatura*'s power, has more serious implications.

Agency-costs analysis does not offer clear predictions as to how the authorities might respond to these problems, but it can suggest some lines of attack. Autarky within the *nomenklatura* and the growth of the second economy outside of it implies the erosion within the elite of a consensus about the boundaries of acceptable economic behavior. If the *nomenklatura* nonetheless wishes to maximize the rents it collects, it may prefer to substitute price-based penalties (*i.e.*, taxes) for the sanctions currently imposed on private activity.<sup>35</sup> A policy of legalizing and taxing private activity, under the constraints that agency-cost analysis indicates the *nomenklatura* will face, may entail greater benefits for the elite at a lower cost, even though it involves a voluntary surrender of some of that group's monopoly of economic and political power.

## Reform and Reorganization

In the years after Stalin's death, poor economic performance and deteriorating political control manifested themselves, *inter alia*, both in the form of steps taken to correct them and by the need periodically to



repeat these reforms. From Khrushchev through Chernenko, each Soviet leader altered the allocation of responsibilities within the hierarchy and otherwise tinkered with aspects of the central planning mechanism. But in every case the Stalinist structure manifested its resiliency, and the reforms ended up either engulfed or co-opted.

This cycle does not comfortably fit the bilateral model propounded by Moore and supported by Ioffe and Kushnirsky. The record reveals a complex dynamic, rather than a simple progression of central power augmented at the expense of firm autonomy. The steady erosion of formal firm autonomy reflected more the successful resistance of the ministries and the *oblast'* leaders to measures initiated by the center. A paradoxical product of this dynamic, as the trilateral agency-costs analysis would predict, was a steady growth in the ability of firms to evade the demands of both the central and intermediate bureaucracies through participation in the second economy.

### **Khrushchev: First Steps, 1956-64**

After consolidating his position as head of the Party and government bureaucracies, Khrushchev attempted to improve the Stalinist administrative structure. The most ambitious step involved the reduction, and eventually the elimination, of the Moscow-based ministries in favor of regional economic councils (*sovmarkhozy*). This reorganization, announced in 1957, attempted to confine the central managerial apparatus to that of goal-setter and general overseer; the councils were to take over the responsibility for most distributional, production, and investment decisions.<sup>36</sup>

Although, had it succeeded, Khrushchev's reform would have subverted departmentalism by displacing the coalitions that had formed within the ministries, it might have strengthened localism. It augmented the power of regional political authorities by designating the *oblast'* as the basic organizational unit of the economy. Perhaps in response, Khrush-

chev in 1962 bifurcated all *oblast'* party organizations into co-equal industrial and agricultural party committees.<sup>37</sup> He explained that bifurcation would enable the local party leadership to concentrate on the particular needs of industry and agriculture, but the restructuring, had it stuck, would have exploited competition between the overlapping territorial units to check the tendency toward autonomy.

Along with these attempts to reorganize the territorial party units, Khrushchev moved against enterprise managers who might have gained too much power from the other organizational changes. At his instigation, the Supreme Soviet restored the death penalty for major economic crimes such as embezzlement of state property, and then applied this new penalty to persons who had been convicted before its enactment.<sup>38</sup> Although this egregious exercise of *ex post facto* punishment provoked international outrage, it undoubtedly got across to enterprise managers the message that self-seeking behavior would entail significant risks.

Seen in their totality, Khrushchev's reforms only weakly confirm Moore's bilateral agency-costs analysis. The most prominent step— the *sovnarkhoz* reform— did not survive, Moore argued, precisely because it dissipated central control over firms by diffusing authority and interrupting lines of communication.<sup>39</sup> The claim that the reforms reflected the Soviet leadership's search for ways of containing agency costs grows stronger, however, if one recognizes that, consistent with agency-cost analysis, the leadership will tolerate a measure that increases the costs generated by the center-firm relationship as long as that step results in at least as great a reduction of costs generated by the relationship between the center and intermediate coalitions.

Once one accounts for autarky among intermediate bureaucracies, the objectives of Khrushchev's reforms and the reasons for their failure become clearer. Khrushchev had wanted first to break up existing coalitions that undermined central authority, and had accepted the reduction in control over firms resulting from the *sovnarkhozy* as an acceptable price for

this benefit. The bifurcation of the *oblast'* party structures and the drive against economic crimes at the firm level also fitted into this strategy.

Pursuing the argument, one can assert that Khrushchev's successors dismantled the project not because it raised overall agency costs, but because it threatened to succeed— that is, these measures would have reduced the independent rent-seeking activity of departmental and local coalitions. The possibility that competition among these coalitions might reduce the profitability of this rent-seeking then seemed remote. The welfare loss resulting from the increased agency costs may have been insufficient to outweigh the distributional benefits (as perceived by the coalitions) underlying a devolution of power from the center.

In any event, Khrushchev lacked a clear vision of how his reforms could overcome the emerging intermediate bureaucratic coalitions. Ultimately his economic reorganization only provoked its targets into combining against the reformer. Khrushchev, in the face of universal opposition from the Politburo and the Central Committee, resigned in October 1964. His one enduring legacy was the dismantling of the terror apparatus, the step that had made it possible for the intermediate bureaucratic forces to overthrow him.

### **Brezhnev: The Treadmill with a Vengeance, 1964-82**

At its beginning what we now see as the Brezhnev regime had no single strong leader. L.I. Brezhnev, by becoming the head of the Party, inherited a position previously occupied by Stalin and Khrushchev (restoring in the process Stalin's title— General Secretary— in the place of Khrushchev's First Secretary). Most observers believe, however, that he exercised power only with the cooperation of four or five other Politburo members, and presumably with the tacit support of the branch and territorial coalitions. The present *glasnost'* campaign, as well as objective evidence extant during the period, confirms the impression of a weak central leadership

owing its position to the enmity that entrenched intermediate interests had developed toward Khrushchev.<sup>40</sup>

The power of the intermediate bureaucratic coalitions during the Brezhnev years manifested itself most clearly in cadres policy. Ministerial and *oblast'* heads enjoyed unprecedented job security under Brezhnev, and rank within the central bodies— the Politburo and the Central Committee— increasingly depended on the position one occupied within the ministries or a regional party hierarchy. Not only did the same people tend to hang on to these positions, but when personnel turnover did occur the replacement usually came from within the same unit, typically the Deputy Minister or the obkom second secretary.<sup>41</sup>

With respect to economic administration, the early actions of the new leadership suggested a desire to restore the Stalinist system, albeit without the rigor of terror to ensure loyalty to the center. Brezhnev and his colleagues undid the split of the Party structure at the *oblast'* level, and soon thereafter liquidated the *sovmarkhozy* and restored the pre-1957 ministerial structure. These steps left the formal allocation of responsibilities within the economic command structure essentially the same as they had been at Stalin's death.<sup>42</sup>

A planning reform promulgated at the same time as the restoration of the ministerial structure complicated the picture. The leadership announced changes in the planning process that would stress enterprise profit rather than gross output, and a transfer of most decision making authority from the ministries to enterprises. Party and government decrees required enterprises to shift from planned-based production, brokered through the ministries, to customer-oriented production governed by contracts negotiated directly between enterprises. The official term for this combination of greater enterprise autonomy and production for sale was “strengthening the economic mechanism”, implying some substitution of market for plan.<sup>43</sup> Even more ambitious projects for bolstering market forces appeared in the academic literature, suggesting

that the leadership had a serious program for reducing the role of *Gosplan* and the ministries in the economy.<sup>44</sup>

Events soon proved otherwise. Almost immediately upon the announcement of the steps to strengthen the economic mechanism, ministries issued instructions undercutting them and re-instituting the Stalinist system of gross output targets.<sup>45</sup> In retrospect, the planning reform may have represented an attempt to check the growth of localism and departmentalism that inevitably would follow upon the abolition of the *sovnarkhozy* and the restoration of the ministries in their Stalinist form. But because the reform measures relied more on aspiration than self-implementing and easily monitored rules, and lacked a solid political base, the ministerial coalitions emerged triumphant.

In combination, the effective ministerial reorganization and the failed planning reform set a pattern to which later attempts to tinker with the Stalinist administrative system conformed. The top leadership would authorize measures designed to check the tendencies toward autarky in the ministerial and territorial units. But because the leadership could not rule without the cooperation of the coalitions that had formed within these units, the reform package also would contain provisions that confirmed the status of these coalitions or even strengthened their authority. The coalitions would subvert the package by ignoring those measures intended to limit autarky and exploiting the provisions meant as concessions. Neither as designed or implemented would the reforms improve the performance of the economy, and as implemented they would, in terms of economic power and the ability to collect economic rents, favor the intermediate coalitions to the detriment of the top leadership. And these developments would set the stage for the next round of reform.<sup>46</sup>

By the early 1970s Brezhnev had gained some degree of prominence in relation to his colleagues on the Politburo, perhaps because of foreign policy successes (detente and summitry) or possibly because of a growing awareness among the top leaders that they were losing ground relative to the lower echelons. Some attempts to reassert central leadership fol-

lowed. In 1972 the Politburo fired three republic Party leaders who had presided over especially wide-open autarkic local economies, and in 1973 and 1974 it announced a reorganization of economic management that, if successful, might have undermined the ministerial coalitions.

One component of the 1965 program had been the replacement of *glavki*— ministerial departments that allocated credits to and collected output and profits from enterprises— with industrial associations (*promyshlyenniye ob"yedinyeniya*) intended to operate on the basis of *khozraschyot*. The 1973 decree conceded that the ministries had not promoted industrial associations and declared that now they must.<sup>47</sup> The next year a similar decree ordered the ministries to begin to merge enterprises into combines or production associations (*proizvodstvyenniye ob"yedinyeniya*) as a means of achieving economies of scale and facilitating transfer of innovations within the enterprises.<sup>48</sup>

Both John Moore and Olimpiad Ioffe have characterized the 1973-74 changes as centralizing steps designed to increase the leadership's control over firms at the expense of economic performance.<sup>49</sup> But their arguments fail either to identify how the associations promoted centralization or to explain how the ministries managed to thwart this goal. Moore contended that imposing *khozraschyot* on the industrial associations lowered the cost of monitoring their performance as compared to the former *glavki*, the track record of which would be buried in the ministerial budget. Ioffe characterized the creation of the associations as the final step in the liquidation of the 1965 planning reform. Yet the available evidence suggests that the new industrial associations did not implement *khozraschyot*, and Ioffe elsewhere has asserted that the decentralizing aspects of the 1965 reform had become a dead letter long before 1973.<sup>50</sup>

Again, Moore's and Ioffe's analysis failed to take account of ministerial and *oblast'* autarky. They did not see how the change might have increased both the authority of the central leadership and the autonomy of enterprises, if it had succeeded in reducing the power of the ministries.

Some evidence suggests that the industrial and production associations had exactly this objective.

The leadership intended both forms of association to promote vertical integration, a goal that necessarily meant revising the highly segmented production process created by the Stalinist system's division of responsibility among the ministries.<sup>51</sup> The associations, had they taken hold, would have displaced the ministries. As a result, the ministries would have fewer resources over which to assert their autarkic power. Both central and enterprise autonomy would have grown at the expense of the intermediate coalitions.<sup>52</sup>

But for the same reasons that the central leadership could not launch a frontal attack on the ministries, its attempt to effect an end run around the bureaucracy failed. For the most part the ministries coopted the industrial and production associations. As in 1965, the reorganization of *glavki* into industrial associations resulted only in title changes. The ministries honored the command to create production associations, but retained the independent organizational and legal identity of the enterprise.<sup>53</sup> In some, perhaps many, cases the enterprise managers played off their new bosses against the other coalitions competing for their allegiance. By increasing competition for their services, the enterprise heads— and coalitions formed at the enterprise level— increased their functional authority in relation to the ministries and other central planning organs.

Whether due to these administrative developments or to some other factor, the period from 1974 to 1982 saw enormous growth in the real autonomy of non-*nomenklatura* economic actors. The second economy mushroomed during these years. One recent Soviet study estimates that in the consumer services sector the second economy quintupled between 1973 and 1988, most of the growth occurring during the Brezhnev years.<sup>54</sup> As the formal restraints on firm autonomy grew, many firms— particularly those involved in agriculture, services, and consumer goods— increased their functional independence through diversion of their products

to illegal distribution channels. By the time of Brezhnev's death, it had become apparent not only that many economic decisions were being made at the branch and *oblast'*, rather than central level, but that much economic activity had slipped away altogether from both the central and intermediate elites' control.<sup>55</sup>

Several studies have tied the mechanisms by which the intermediate elites pursue their autarkic goals to the growth of the second economy.<sup>56</sup> First, enterprise managers needed to cultivate their superiors in the ministry to ensure sufficiently low plan requirements and adequate access to inputs. At the same time they had to develop alternate sources of inputs and covert means of obtaining amnesty for inability to meet production quotas as insurance against ministerial failure to look after their interests. With respect to inputs, enterprises had to hide production from the ministry so that the manager could trade with other enterprises to remedy input shortfalls.<sup>57</sup> To avoid punishment for failure to meet plan targets, managers had to agree to hold harmless other enterprises with which they have entered into contracts for the purchase or sale of goods.<sup>58</sup> These strategies require even the most conscientious managers to operate outside the law. As a result, they became vulnerable to pressures by the intermediate bureaucratic elites to cooperate in illegal autarkic projects, and faced low marginal costs when choosing to engage in illegal activity for their own benefit.

A typical pattern might begin with an initial demand by the intermediate *nomenklatura* that a firm manager pay tribute. Due to plan tautness, the manager could make these payments only by embezzling state property. The tribute-seekers in turn would protect the manager from detection of and punishment for this crime, as they otherwise would lose their tribute. This course of conduct, to the extent it forced managers to absorb the additional risks of penalties, further lowered the marginal cost of personal rent-seeking. The cycle also existed within the firm, as in the service establishment where the manager anticipated his sales personnel would steal and demanded a commission.<sup>59</sup>



During its waning years the Brezhnev leadership made one last attempt to attack the problem of bureaucratic coalitions through organizational change. A 1979 decree, like its predecessors, ordered the creation of planning indicators that would make enterprises more sensitive to consumer demand and less dependent on the ministries' gross output target.<sup>60</sup> Also like its predecessors, it had no significant effect on the behavior of ministries or enterprises. In addition, several key areas of industrial production— the West Siberian oil and gas complex, the food program, and environmental protection— received new administrative structures in the form of special commissions attached to the USSR Council of Ministers.<sup>61</sup> Ideally the regime would have used these structures to consolidate its grip on the affected sectors, presumably by abolishing the subordinate ministries and reassigning administrative responsibilities. Instead it could do no better than create another, apparently redundant layer of management, which failed at the main task of undercutting ministerial autarky.<sup>62</sup>

The bilateral agency-costs model cannot explain the “period of stagnation”, and particularly the ineffectual central leadership the term implies. Why did the highest political echelons choose reforms that augmented rather than diminished the effective autonomy of both the intermediate coalitions and firms? Only by modifying the analysis to account for autarky can we explain why a ruling clique bent on maximizing its control would end up sacrificing both productivity and power.

In sum, the Brezhnev era, as it developed into the “period of stagnation”, exposed the latent contradiction between Stalinist administrative structures and the *nomenklatura's* goal of maximizing its power. The intermediate coalitions, exploiting the leeway given them in the wake of Khrushchev's ouster, became increasingly aggressive in their rent-seeking. As their demands on firms increased, so did the opportunities grow for firms to obtain side payments in the form of protection from central scrutiny. By the 1970s many firms, particularly in those industries where product diversion did not require substantial additional capital, had used

this protection to strike out on their own. How successful they were is becoming clear only later, as articles in the press began to document this activity in order, *inter alia*, posthumously to discredit the Brezhnev regime.<sup>63</sup>

### **Andropov and Chernenko: Labor Discipline, 1982-85**

Within the span of a few months many members of Brezhnev's Politburo — Kosygin, Suslov, Kirilenko, Pel'she, and Brezhnev himself — expired. Yu.V. Andropov assumed Brezhnev's posts as General Secretary and head of state in November 1982 and promptly launched his own reform program. The campaign had three components, two of which were new: a slight increase in the amount and quality of published information about the economy; a strong emphasis on labor discipline, applicable to both bureaucrats and blue-collar workers; and further tinkering with organizational forms and the planning mechanism along the lines of the failed 1965, 1973-74, and 1979 reforms.

The modest increase in publicly available information comprised such measures as reports on the weekly meetings of the Politburo, including abridged minutes; candid discussions of the existence (although not the extent) of corruption in the economy as well as of ministerial and local resistance to central initiatives; and the first glimmerings of a cultural thaw in the theater and cinema. Although mostly symbolic, these steps ran counter to a centralizing policy, since they degraded somewhat the value of the closely held information that the elite used to define and maintain its status. Although not yet *glasnost*' (for example, the regime did not acknowledge that Andropov had a wife until after his death), the new information policy hinted at a broader liberalization.

The labor discipline campaign had a more centralizing tone. Shortly after Andropov took power the press announced the disgrace and arrest of several prominent figures who had led corrupt coalitions, including the head of the Soviet police (MVD). In a series of highly publicized personal

appearances Andropov promoted the concept of labor discipline — the expectation that both workers and bosses would stop the shirking and petty theft that had become endemic in the Soviet workplace. To thwart worker attempts to evade these restrictions, the government created new constraints on worker job mobility.<sup>64</sup> Finally, as the showpiece of the entire campaign, the Supreme Soviet enacted the Law on the Labor Collective, a measure that promised some workplace democracy but portended much workplace discipline.<sup>65</sup>

Reorganization under Andropov took two forms: the creation of an additional supervisory layer in the MVD, and yet another attempt to implement the planning reforms announced in 1979. The MVD reorganization, which followed a major personnel turnover, mimicked the longstanding administrative structure of the military, in which political officers in each unit reinforce party control.<sup>66</sup> The planning reform, like its predecessors, attempted to encourage enterprise managers to innovate by tying planning indicators to profitability and success in satisfying consumer demand. Unlike the earlier projects, however, these measures applied only to five selected ministries (the USSR Ministries of Heavy and Transport Machinery and of the Electrical Equipment Industry, the Ukrainian Ministry of the Food Industry, the Byelorussian Ministry of Light Industry, and the Lithuanian Ministry of Local Industry) rather than to the whole economy.<sup>67</sup>

Superficially, the reorganization of the MVD seemed a centralizing step. Corruption among MVD officials, particularly those in the BKhSS, the division responsible for combatting economic crime, made the second economy possible. The hunger of police for bribes and tribute may even have corrupted otherwise upright enterprise managers. The addition of a new layer of MVD supervisors, beholden to the Party rather than to the Ministry, could have raised the cost of corruption and thereby strengthened central control.

At the same time, the reorganization may have set in motion forces that over time could diminish central authority. The new political officers,

after an initial period of rooting out corruption, would have an incentive to report full compliance with Soviet law. They could achieve this goal either by repressing illegal behavior or, at a lower cost, suppressing information about corruption. Although beholden to the Party bureaucracy, they also would need to enlist the support of the MVD departments they supervised. Presumably they could obtain cooperation only by turning a blind eye to less glaring defections. The more ambitious political officers even could take advantage of their positions to coordinate and organize corruption, a task they could execute more efficiently because of their central position. On the other hand, enterprise managers might have some additional leverage to elude central supervision and to engage in rent-seeking of their own by playing off the regular MVD officials against the political officers.

In the light of the background of corruption and failure, one cannot easily characterize the 1983 planning reform as either a centralizing or a decentralizing step. Its modest ambition— it was termed an “experiment” rather than a reorganization, and it applied only to a small fraction of the economy— suggests some effort to concentrate the center’s forces and thereby to avoid the ministerial obstructions that had subverted the 1965 and 1979 reforms. In all other respects, however, the 1983 decree repeated the same formulations and took the same tried-and-failed steps as did its predecessors. It exhorted the planning agencies to substitute normatives (*normativy*) based on quality and profitability for gross output indicators, and to encourage enterprises to accumulate funds in proportion to profits generated. It required enterprises in the affected ministries to shift over to a system of full *khozraschyot*, *i.e.*, the elimination of all ministerial subsidies and the retention of all profits by the enterprise. But it did nothing to prevent ministries from placing state orders directly with their subordinate enterprises, which effectively preempted production that an enterprise otherwise could have sold through autonomous contracts with other enterprises. More importantly, the experiment left in place the system of state-controlled prices, which resulted in the imposition of in-

direct subsidies and taxes that frustrated the realization of whatever benefits the “economic mechanism” otherwise might have accomplished.<sup>68</sup>

A model that allows only for a dichotomy between centralized power and enterprise autonomy does not advance our understanding of the Andropov reform measures. The information policy and the 1983 planning experiment pointed toward moderately increased enterprise autonomy, while the labor discipline program (especially the anti-corruption campaign) and the MVD reorganization smacked of centralization. No general pattern emerges.

An agency-costs analysis that incorporates the intermediate bureaucratic coalitions and the second economy offers a better explanation of what the Andropov leadership meant to bring about. The labor discipline campaign and MVD reorganization attempted to raise the cost of participation in the second economy, while the new information policy and the planning experiment attempted, in an admittedly half-hearted fashion, to disrupt the intermediate coalitions. Lacking a consensus that the welfare costs, as opposed to the distributional consequences, of the Stalinist system had become intolerable, the leadership took no bold steps. But what movement in economic law did occur followed the pattern predicted by this analysis.

Disease cut short Andropov's opportunity to implement any deeper vision he might have had of a reformed Soviet society. During Chernenko's brief tenure as Party leader and Chief of State the leadership neither retreated from Andropov's programs nor took any new steps to grapple with the emerging problems of the Stalinist system. Taken together, the Andropov and Chernenko periods reveal a leadership slowly realizing that a managerial system designed to maximize the power of the *nomenklatura* over the economy had slipped, and in the foreseeable future might not work at all. This was the system that Gorbachev inherited when he became General Secretary of the Party in March 1985.

## Perestroika and Economic Law

Much to the inconvenience of Western analysts, *perestroika* is a moving target, a concept that changes in form and content as events unfold in the Soviet Union. Although Gorbachev has spoken of a “radical economic reform” since he first took office, the terms of the project seem to have changed. At first *perestroika* embraced, with perhaps more vigor than previously exhibited, the elements of Andropov’s reform program—relaxation of controls on information, labor discipline, and reorganization of the bureaucracy. Since 1987 the leadership has flirted with more ambitious reforms, including privatization in important sectors of the economy.

I will discuss in turn the four main aspects of *perestroika* in economic law — labor discipline, bureaucratic reorganization, *glasnost*, and privatization. As the campaign has developed, different elements have predominated. A preliminary assessment suggests that the steps taken are consistent with the goal of increasing the authority of the central authorities at the expense of the intermediate bureaucratic coalitions. At the same time, the picture remains confused, suggesting the need to add more than the usual caveats to any proffered explanation.

### Labor Discipline — The Anti-Alcohol Campaign

The first of Gorbachev’s major reforms, and the one that affected the lives of average Soviet citizens most directly, involved a multi-front attack on the pervasive vice of alcoholism. The Presidium of the Republic Supreme Soviets, on cue from the central leadership, amended their criminal codes to strengthen the restrictions on alcohol abuse, workplace supervisors acquired enhanced authority to punish drunken workers, the stores stopped selling hard liquor except for limited times and in limited amounts, prices rose drastically, and the government began shifting production away from

distilled spirits and toward wine, beer, and fruit juices.<sup>69</sup> These factors raised substantially the cost of drinking alcohol.

Andropov had instituted the concept of a labor discipline campaign, but by attacking alcohol abuse Gorbachev struck at the main source of time theft, absenteeism, and poor workplace performance. The primary goal probably was to increase productivity, and hence the amount of wealth subject to the *nomenklatura*'s disposal, without surrender of central or intermediate authority. A secondary goal might have been restriction in the supply of a commodity that played an important role in the second economy. Vodka was almost the only good that rubles could buy directly and in substantial quantities, without requiring bribery or string pulling. As such, its purchase was one of the few ways of disposing of earnings generated in the second economy. By increasing the price of vodka, the leadership may have hoped to devalue the fruits of illegal enterprise.<sup>70</sup>

Previous Soviet governments had attempted similar steps, but in important respects Gorbachev's program differed. The earlier campaigns, like economic reform generally, had existed mostly on paper and had left no substantial impact on the population. A 1972 anti-alcohol program, for example, had petered out quickly due to bureaucratic indifference and the unwillingness of the authorities to forgo the revenue generated by vodka sales.<sup>71</sup> Meanwhile per capita alcohol consumption increased by 60% during the Brezhnev years, exacerbating an already serious social problem.<sup>72</sup> Gorbachev, by contrast, meant business. Within weeks of the campaign's start, alcohol became a scarce and expensive commodity throughout the Soviet Union.

Over the short term, the campaign scored significant successes. According to Soviet sources, alcohol consumption dropped by over forty percent between 1984 and 1987, and alcohol-related deaths declined by more than half between 1984 and 1986.<sup>73</sup> By 1987, however, it had become clear that the private sector had responded robustly to the incentive caused by the state-created scarcity. Before the campaign Soviet moonshine (*samogon*) had accounted for something like thirty percent of all

alcohol consumed in the Soviet Union.<sup>74</sup> By 1988, in spite of the stricter penalties for moonshining, *samogon* constituted more than a half of all alcohol consumed. Sugar shortages (sugar being the principal ingredient in *samogon*) became notorious. Paralleling the American experience with Prohibition, large, well-organized criminal gangs took over much of the distribution.<sup>75</sup>

Up to this point, the anti-alcohol campaign seemed doomed to recapitulate the fate of all earlier economic reform programs: a restructuring designed to strengthen central control and the value of membership in the *nomenklatura* became a means for the creation of private wealth. Rather than destroying the market for *samogon* and increasing the risks attendant on its production, the anti-alcohol campaign simply raised the rate of return in the industry and encouraged more complex forms of organization and marketing techniques. Although the rise in the price of (legal and illegal) alcoholic beverages may have reduced somewhat the spending power of rubles earned in the underground economy, the expansion of the *samogon* industry more than made up for these losses.

In the latter half of 1988, however, the authorities began to break out of this cycle. The Moscow local government, with great fanfare, announced the opening of several hundred retail outlets for “soft” alcoholic beverages— wine, champagne, and beer.<sup>76</sup> The Party Central Committee, reviewing the campaign it had initiated three-and-a-half years earlier, conceded how much had gone astray. The actions taken to suppress alcohol, its decree declared,

[T]urned alcoholic beverages into something in high demand and led to long waiting lines, a sharp increase in moonshining, speculation in liquor, addiction to toxic substances and drug addiction. Difficulties arose with trade in sugar and confectionery products. The reduction in commodity allocations of alcoholic beverages did not ensure a corresponding increase in the proportion and sale of necessary goods and paid services.<sup>77</sup>



Although not indicating a complete reversal in the campaign, the decree instructed the responsible authorities to make it easier for the Soviet population to buy alcoholic beverages.<sup>78</sup>

### **Industrial Reorganization**

The search for the right industrial administrative structure that had occupied the leadership for so many years has continued under Gorbachev. As in 1957, 1965, 1973, and 1979, decrees have called for the freeing of enterprises and production associations from the “petty tutelage” of ministerial bureaucrats and for the strengthening of the “economic mechanism” through the broadening of *khozraschyot* and the basing of production targets on inter-enterprise contracts rather than on state orders. New administration structures have arisen, sometimes supplanting and sometimes merely supplementing existing bureaucratic entities. Some reorganization at the territorial level also has taken place, including the realignment of some *oblast'* boundaries and the promotion of inter-*oblasty* economic projects. Promises of economic autonomy for the Baltic Republics, although not yet realized, may result in greater pluralism within the Soviet economy. One much-heralded statute — the Law on the State Enterprise — purports to state new guarantees of enterprise independence and autonomy.<sup>79</sup>

### **Super-Ministries and Other Departmental Reorganizations**

The reorganization of the ministerial bureaucracy, to date, hardly justifies the label “radical reform.” In the years before Gorbachev came to power, prominent economists had proposed the elimination of almost all the ministries, national and Republic. As restructured, the Soviet economy would comprise two levels: national (or Republic) planning agencies such *Gosplan*, *Gossnab*, *Gosstroy*, *Gosbank*, and a handful of superministries;

and production associations or enterprises. The authorities would free prices to reflect supply and demand, and would allow most economic decisions to be made at the enterprise level through market purchases and sales.<sup>80</sup>

The steps taken fall short of this ideal. For the first four years the leadership contented itself with personnel changes rather than structural reorganization. The government abolished or consolidated a handful of ministries and state committees while creating others.<sup>81</sup> Following the pattern set during the Brezhnev years, it established new Interdepartmental commissions attached to the Council of Ministers.<sup>82</sup> At the first session of the new Supreme Soviet in 1989, the legislature abolished an additional twenty-five ministries and state committees, but left fifty-seven departments in operation.<sup>83</sup>

In spite of the most recent cuts in the number of economic departments, Gorbachev has made no significant progress in simplifying and rationalizing the government's departmental organization.<sup>84</sup> Rather than realizing the economists' notion of reducing the administrative apparatus to two layers— the Council of Ministers and a superministry— the present system can place as many as five administrative layers over an enterprise— in descending order, the Council of Ministers, a bureau, a Ministry, an industrial association, and a production association. In spite of the fact that the overwhelming majority of ministers and state committee chairmen have received their appointments under Gorbachev, and therefore owe him a presumed political debt, the power of departmentalism seems sufficient to frustrate a frontal assault on the ministerial structure.<sup>85</sup>

Gorbachev has had greater success in streamlining the Party's departmental structure. In September 1988 the Central Committee, at Gorbachev's behest, reorganized its Secretariat. It eliminated the nine separate economic departments, replacing them with two separate commissions for agrarian and for social and economic policy.<sup>86</sup> To the extent these commissions exercise the traditional powers of the former

Secretariat departments in supervising the economy, the reduction may counteract the entrenched departmentalism in the Council of Ministers. But paradoxically, if the Secretariat reorganization achieves its professed objective of reducing the influence of the Party bureaucracy over the management of the economy, the Party will have less leverage over the intermediate coalitions.

### Regional Reorganizations

Many of the economists who wanted to dispense with the economic ministries also believed that regional economic coordination could replace much of the administrative power currently exercised at the national level. They did not envision a reconstitution of Khrushchev's *sovnarkhozy*, which operated at the *oblast'* level, but rather the development of inter-*oblast'* and even inter-Republic coordinative bodies.<sup>87</sup>

Gorbachev has not yet realized this project. In 1986 the leadership issued a decree calling on regional bodies, especially local soviets, to assume more responsibility in economic decision making, but details of accomplishments remain sparse.<sup>88</sup> Rather the leadership has taken tentative steps toward creating political foundations for regional coordination.<sup>89</sup> On the political level, the central authorities have replaced almost all the Republic party bosses and the overwhelming majority of *oblast'*-level leaders. They also have ended the Brezhnev-era practice of automatically including Republic party leaders in the Politburo.<sup>90</sup> Corresponding legal changes include redistricting the *oblasty* in the Central Asian Republics, a move that disrupts existing bureaucratic coalitions and may impose substantial renegotiation costs on new ones that might be formed.<sup>91</sup>

Another approach to regional economic reorganization would enhance the right of the Republics to operate independently of Moscow in economic and political matters.<sup>92</sup> Gorbachev appears to have adopted this strategy selectively, permitting autonomy in those areas (e.g., the Bal-

tic states) where intermediate coalitions traditionally have not played a significant role, but discouraging it in places such as Uzbekistan and Kazakhstan where strong republic-level coalitions have thwarted Moscow's rule and promoted the growth of the second economy. In the spring of 1989 the leadership issued a draft of general principles to govern the economic relations between the central and republican governments. It contained general promises about transferring various economic functions to republic and local control but lacked concrete measures for extending republican authority.<sup>93</sup> In response to more ambitious efforts by the Baltic states to develop private property and freer markets, the Supreme Soviet has endorsed expanded economic sovereignty for that region.<sup>94</sup>

Political independence presents even more difficult problems. Because of *glasnost*, longstanding nationality tensions in the Baltic states, the Ukraine, Moldavia, Central Asia, and Transcaucasia have surfaced, resulting in demonstrations, strikes, and even pogroms as well as attacks on Moscow's rule. The leadership undoubtedly views these events as undesirable. The hard question is whether it will come to regard nationality unrest, along with other "negative" phenomena permitted under *glasnost*, as an acceptable cost of a broader strategy to reform the Stalinist system, or rather as proof of the strategy's failure.<sup>95</sup>

### **The Law on the State Enterprise**

Turning from organizational structures to changes in the legal rights of the enterprise, the same pattern of ambitious projects and modest results appears. A few months after Gorbachev came to power the leadership declared its satisfaction with the results of the 1983 planning experiment and announced its intention of implementing them in the entire economy.<sup>96</sup> Attention soon focused on the proposed Law on the State Enterprise, which the authorities promised would protect enterprises from ministerial interference and would force production units to base their decisions on considerations of profit rather than of command.<sup>97</sup>

The enacted statute has disappointed proponents of *perestroyka*.<sup>98</sup> It gives rhetorical support to the concept of enterprise autonomy by providing for full *khozraschyot*, empowering enterprises to undertake any action not specifically forbidden by law, guaranteeing independence from commitments made by the state, and even addressing the prospect of bankruptcy.<sup>99</sup> The new law permits a firm to buy its inputs and sell its product on open markets, and confines higher agencies to long-term strategic coordination.<sup>100</sup> But the statute also makes clear that enterprises still must transfer a portion of their profits to the state budget, get ministerial and local approval for their plans, obtain inputs through the centralized *Gossnab* structure, and fulfill state orders ahead of other commitments.<sup>101</sup> It also calls on the economic bureaucracy to “counteract the monopoly tendencies of individual enterprises,” an elastic mandate that may permit the quashing of unduly successful firms.<sup>102</sup>

The Law’s one clear innovation involves the creation of a mechanism by which enterprises can resist unauthorized demands placed on them by higher bureaucratic organs. If such a body issues an “act” (*akt*) to an enterprise in excess of its competence or in violation of law, the enterprise may petition an organ of *Gosarbitrazh* to have the act declared invalid.<sup>103</sup> Shortly after the promulgation of this procedure, several enterprises threatened to invoke this power to force their superior ministries to retract directives. In no case did an enterprise proceed all the way to arbitration, however, and press reports suggest *Gosarbitrazh* has not yet readied itself to handle these disputes.<sup>104</sup> In any event, *Gosarbitrazh* can provide no relief if a directive merely makes bad economic sense, such as an order for a product that carries with it built-in losses or requires unobtainable inputs.<sup>105</sup>

A deeper problem involves those enterprise directors who wish to collaborate with their bureaucratic superiors rather than run the risks associated with autonomy. The Law contains nothing to deter enterprises from filling up their production capacity with state orders from the ministry rather than reserving production for market sales. Given the present

irrationality of the price structure, the reform of which remains distant, managers may prefer the safe harbor these orders provide.<sup>106</sup> The result would be confirmation of the Stalinist system of management, not its overthrow. A 1989 amendment forbids the issuance of state orders that would consume all of an enterprise's output and permits a firm to challenge improper state orders, but it does nothing to deter enterprise directors from choosing to commit all their production to the state in order to avoid dealing with the vagaries of the market.<sup>107</sup>

The 1989 amendment also authorizes enterprises voluntarily to decompose through subcontracting. The enterprise can lease portions of its property to other firms, including privately owned entities such as cooperatives and joint enterprises. The law even allows an enterprise, "on the transition to lease relations," to withdraw entirely from ministerial and regional control and to replace administrative supervision with contractual rules.<sup>108</sup> This bare authorization, although impressive, greatly needs elaboration. There exist no clear rules as to the respective property rights of an enterprise and its superior ministry, particularly with respect to trade secrets, know-how, and other forms of intellectual property. How can an enterprise decide to free itself from ministerial authority without knowing the price of freedom?

### **Industrial Associations**

A less dramatic but still significant illustration of the difficulties the leadership has encountered in simplifying the administrative apparatus involves the subministerial industrial associations. As noted above, these entities first emerged as part of the 1965 reform but received renewed support in 1973 as a means of undercutting ministerial authority. Having failed in this purpose, they serve no function except as a potential player in a game of bureaucratic competition that can lead to greater enterprise autonomy.<sup>109</sup>

Recognizing that this layer of management has not justified its cost, the leadership in 1986 proposed eliminating industrial associations from the organizational hierarchy.<sup>110</sup> A year later, a decree of the Council of Ministers took the more modest steps of requiring industrial associations to maintain a system of full *khozraschyot* (that is, eliminate all subsidies from the state budget) and encouraging them to develop across branch lines.<sup>111</sup> The decree attempted to clarify the chain of command when an industrial association embraces enterprises from more than one ministry, but its wording left sufficient room for turf wars and the kinds of strategic behavior that have bedeviled these entities in the past.<sup>112</sup>

In some cases industrial associations have transformed themselves into concerns (*kontsyerny*), state-owned conglomerates that operate enterprises free of particular ministries. Reports appeared in the Soviet press during 1988 about the existence of these entities, although their legal basis remained obscure.<sup>113</sup> The 1989 amendments to the Law on State Enterprises allude to these organizations but provide no clear guidance as to their creation or rights.<sup>114</sup> Risk-preferring managers can exploit this legislation to create organizational structures that can compete with the traditional ministerial lines of authority, but the leadership has not yet decided to insist on such conversions.

### **Reorganization in Perspective**

After four years of power, Gorbachev still has not realized any of the ambitious projects for reforming economic management that the economists had proposed. For the most part the changes that the government has implemented seem strikingly similar to measures undertaken during the Brezhnev era. If the leadership intends to reverse the erosion of its economic and political power, none of the alterations it has made in the administrative apparatus seems likely to help.

Following Moore's bilateral agency-cost analysis, one might explain the leadership's failure to achieve any substantial managerial reforms as

the product of its ongoing concern about enterprise autonomy. To the extent that firms do buy and sell through markets rather than cooperating with the centralized management system, and that local authorities have a greater say in investment decisions and the supply of services to the workforce, the *nomenklatura* would surrender power and thereby suffer a welfare loss.<sup>115</sup> The fact that the leadership has given little more than rhetorical support for these developments suggests its continued desire to avoid this result.

A trilateral analysis gives a somewhat richer, although not strikingly different, account of both Gorbachev's successes and failures with respect to organizational reform. The combination of *vedomstvennost'*, *mestnichestvo*, and the second economy has generated large agency costs for the *nomenklatura*. But the intermediate bureaucratic coalitions that produce most of these welfare losses have managed to offset their own share with significant distributional gains through encroachment on the prerogatives of the central elite. From the perspective of these coalitions, *perestroyka* has yet to prove itself a preferable alternative.

In the absence of a terror apparatus firmly controlled by the center, reining in the bureaucratic coalitions involves high negotiation costs. Members of the coalitions are numerous and far flung, and the coalitions themselves rest in large part on unstated and informal ties rather than on explicit bargains that easily can be redone. Many of the members reasonably believe they will be net losers under a reformed administrative structure, and the leadership has not come up with ways to compensate them through side payments.<sup>116</sup> Moreover, although many low-level producers might welcome the opportunity to end the system of extortion and tribute through which these coalitions maintain their hold, others, presumably the more ambitious, have pursued their fortune in the second economy.

In sum, the combination of ambitious administrative reform projects and modest achievements reflects an ongoing struggle between the center and the intermediate elites. The projects reflect the wishes of the central



leadership, which hopes both to regain its former powers and to reduce the agency costs now associated with the Stalinist system. The modest steps actually taken, on the other hand, reveal the difficulty of enlisting the support of the intermediate coalitions.

### **Glasnost' – A New Information Policy**

Historically, information has been one of the scarcest, and therefore among the most valuable, goods in the Soviet economy. The *nomenklatura* has defined itself as much by its access to information as by its control over more tangible goods. This tradition antedates Soviet rule but gained great force from Stalin's need to conceal the terrible means by which he attained supreme power. A non-economic explanation for the extreme secretiveness of his regime is that the collaboration of the Stalinist leadership in truly horrible crimes, and the lies they told to conceal their guilt, created a bond that demanded a cult of secrecy.

Although some cracks in the system had appeared before Gorbachev came to power, the real transformation in Soviet information policy has taken place only in the last three years. Until the middle of 1986 the official Soviet approach to sensitive or embarrassing, as well as useful, information had not changed much since Stalin's death. Penalties for disclosure had diminished since Khrushchev had dismantled the terror apparatus, and in private Soviet academics and officials could display remarkable candor, but for the most part the press and other governmental publications gave out almost nothing of any use.

Several events seem to have triggered Gorbachev's loosening the bounds of secrecy. The first days of the Chernobyl disaster in the spring of 1986 displayed the worst aspects of the old system. The government's initial refusal to acknowledge the existence, and then the scope, of the accident provoked distrust and anxiety abroad and at home. When Gorbachev, two weeks after the event, spoke on television and gave a sober and detailed account of the tragedy, the leadership found instructive the

relatively positive reception. In the late fall of that year Gorbachev faced his first serious crisis within the leadership, when the dismissal of Kazakh Party leader D.A. Kunayev led to bloody rioting in Alma Ata. This time the Soviet media responded immediately with full coverage.

Aside from the intrinsic value of the story, the behavior of the press during the Kunayev affair sent an important and unmistakable signal to the Soviet population: The boundaries of acceptable public discourse had expanded enormously. Within months the leadership had freed Andrey Sakharov, the most prominent dissident, from his internal exile and had restored him to respectability. A new industry of anti-Stalinist film and literature blossomed. The word *glasnost*' became a commonplace in both the Soviet media and in the West.

Like its antecedent system of secrecy, Gorbachev's new information policy lacks a legal basis, in the sense of formal documents of legislative significance stating its dimensions.<sup>117</sup> Rather one can trace its scope from what the leadership has allowed to go unpunished. These boundaries remain obscure, dependent as they are on both the vigilance of the authorities and the courage of publishers. Nonetheless a few generalizations, based on impressions from the Soviet media and academic press, remain possible.

Much of *glasnost*' has had little to do directly with economic reform. The authorization of a cascade of creative and historical works that explore Stalin's terror and the rehabilitation of literary and artistic figures who found themselves at odds with Stalinism reflect mostly a bid for the loyalty of the *intelligentsia*, a class that the leadership hopes will generate inspirational support for reform. But *glasnost*' also has meant the release at the national level of more, and more reliable, non-statistical information about the economy, and the emergence of the national and local press and electronic media as autonomous actors in *perestroyka*.<sup>118</sup>

From the perspective of a bilateral agency-costs analysis, *glasnost*' makes no sense and ultimately must be abandoned. Starting from the premise that the holding of scarce information constitutes a principal form

of the *nomenklatura's* wealth, the popular dissemination of significant news represents an inexplicable welfare loss. One might attack the genuineness of *glasnost'*— characterizing it, for example, as a Potemkin village of press freedom designed to curry favor in the West without threatening the real interests of the regime— but otherwise the new information policy cannot be reconciled with Moore's model.

The genuineness argument has a crucial flaw— much of the information released under *glasnost'* has no audience in the West, aside from close observers of Soviet affairs, but touches critically on matters of vital concern to the *nomenklatura*. For example, few people outside the Soviet Union have paid much attention to the Law on the State Enterprise, but inside the country it has received extensive publicity as well as the explicit personal endorsement of Gorbachev.<sup>119</sup> Yet under *glasnost'* articles have appeared that sharply attack the statute on both process and substantive grounds and document their criticisms with specific examples.<sup>120</sup>

By contrast, the trilateral agency-costs analysis can accommodate *glasnost'*. One can see the new information policy as a logical extension of the struggle between the central and intermediate elites that has produced an impasse over reforming the economy's administrative structures. Industrial reorganization entails a redefinition of the responsibilities of the intermediate bureaucratic elites, and to succeed requires at least their tacit cooperation. Other, more radical measures can bypass the elites, albeit at the risk of bolstering the role of low-level producers. The easiest step for the center to take, although the one that seems most sharply in conflict with traditional Soviet culture, has been the new information policy.

As basic as secrecy and the compartmentalization of information were to the definition of Soviet society, the evolution of the Stalinist administrative system as well as the dying off of those leaders who owed their careers to Stalin made a reconsideration of the cult of secrecy inevitable. Lower-echelon bureaucrats and managers increasingly exploited the compartmentalization of information to frustrate the central leadership. The

“second economy in information,” as Soviets refer to the robust rumor *bourse*, grew to serve the general population, especially in the cities. In light of these developments, the costs of secrecy to the *nomenklatura* began to outweigh its benefits.

Somewhat paradoxically, upgrading the credibility of the national media has strengthened the leadership's ability to influence the general population. The central leadership, compared to the intermediate coalitions, more easily can set the agenda for discussion, even though it no longer tightly controls the content. Greater freedom for the media reduces the aura of cynicism that previously degraded public discourse. Although the leadership may find itself in competition with the media as *glasnost*' develops, at present its power to write the headlines, if not the articles, coupled with the greater tendency of the population to take seriously what they read in the press, has given it a useful tool for striking at its adversaries.

The unleashing of the local media reinforces this process. By encouraging and protecting journalists who uncover misbehavior outside of Moscow, the central leadership has improved its ability to monitor members of the *nomenklatura*. Again, this policy runs a risk of loss of authority to the media, but at least over the short run the welfare gains in terms of enhanced control over local elites may outweigh this risk.

Relaxation of controls over information presents difficult managerial problems. Given the permeability of information, all but the most rigid barriers tend not to work. The Nagorno-Karabakh crisis, as well as the nationality protests in most of the non-Russian Republics, reveals what the leadership must regard as the down side of *glasnost*'. In this sense Gorbachev's new information policy puts at risk the ability of the *nomenklatura* to maintain its dominant position over the long run.<sup>121</sup> As a short-term strategy by which the central leadership might regain ground lost to the intermediate bureaucratic coalitions, however, *glasnost*' may seem an acceptable risk.