

**ENTERPRISE AUTONOMY AND INCENTIVES IN A
SOCIALIST ECONOMY : SOME DEVELOPMENTS
IN THE USSR AND HUNGARY ✓**

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PREFACE

A study of the problem of enterprise autonomy and incentives in a socialist economy, based mostly on the secondary sources of material, is an ambitious task. This itself expresses the limitation of this research work. The study is broad-based, but attempts have been made to go into the details of the problem, as far as possible. Further research in this area will definitely throw light on various other interesting issues related to the socialist economies, which this work has probably failed to focus upon.

During the research work, I had useful discussions with my supervisor, Dr. Arvind Vyas, who had also taken the trouble to go through the draft of my dissertation. I am indebted to him for his comments and suggestions on my work. I must sincerely thank Mr. G.V. Ramana and Mr. T.K. Arun of the Centre for Economic Studies & planning, for the extensive discussions which I had with them on certain conceptual issues related to the present work. I am thankful also to Mr. Sushir Malakar for the trouble he had taken to draw the three schematic diagrams presented in this dissertation.

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INTRODUCTION

The question of enterprise autonomy and incentives in a socialist economy is important in the study of the political economy of socialism, mainly because of two reasons. On the one hand, it determines the role of enterprises in a socialist economy, taking into account the whole question of the process of socialisation, and on the other, it reflects the role of central planning under socialism with specific reference to the problem the economy under central planning faces. Various theoreticians and planners working in this area have tackled this problem at two levels. At one level, a number of writers have considered it as a technical problem, related to the management and administration of the enterprises and have sought solutions in economic methods available to them. At another, the question of enterprise autonomy and incentives has found a political and ideological dimension.

The political economy of socialism had to be developed from its nascent state immediately after the revolution in 1⁹17 in Russia (the present day USSR). Marx's ideas on a post revolution society was not

sufficient to construct socialism. The concrete problems faced by the economy drew the attention of the theoreticians and planners. At this stage itself the question of enterprise autonomy and incentive became more important. Volumes of theoretical work appeared on such issues as related to the role of enterprises and to incentives, based on the basic Marxian framework. The question was tackled more at an ideological and political level than at an economic. Works of Preobrazhensky, Bukharin etc. in the early stage, and of Bettelheim and Brus in the later, differ substantially from one another but emerge from the acceptance (as they thought) of the basic principles of Marxian dialectics. All these writings are rich in political and ideological content, but their failure to arrive at a common position is the result of different priorities set by them on different issues related to the principles of socialism. The question of enterprise autonomy, as it has emerged from the writings of Marx, Lenin, Preobrazhensky, Bukharin, Bettelheim and Brus (also Kornai) have been discussed in section I of the chapter I. In this section we have paid special attention to the ideas

of Bettelheim and Brus, because, their writings are more relevant to the contemporary problems of socialism. We have noted in this section that while dealing with the question of enterprise autonomy, Bettelheim has essentially talked about development of socialist values and the danger of market relations developing as a result of increased enterprise autonomy, which may revert the transitional system to capitalism. Brus, on the other, has attacked the incomplete nature of socialisation in the USSR and other East European socialist countries which has been the outcome of the failure of the political system to democratise itself, as well as, the economy. This directive model of management which leaves the autonomy of the enterprises at the minimum, alienates workers from the means of production. By 'democratisation of the economy' Brus means allowing workers to have effective control over the means and conditions of production. Thus the system of allowing the enterprises to take decisions on the management and planning of the enterprise 'at the work place' is definitely more acceptable to the principles of socialism. The importance of the works

of both Bettelheim and Brus cannot be discounted. But the fact remains that their words do not contribute significantly to the actual problems of the economy. The management of the economy is not merely a technical problem. It has ideological and political relevance. But attachment to ideological and political aspects alone does not help further the understanding on the problems of socialism. The problem of enterprise autonomy was taken up by Kornai at a purely technical level and his model is a brilliant approach to the study of the socialist economies. But Kornai also refused to incorporate the ideological and political questions in his model. The section I demonstrates the incomplete nature of the theories developed on the given problem.

Section II takes into account the ideas and concepts related to incentives. The debate on incentives have taken two directions. In one, the question whether material incentives are compatible with socialist ethics and principles, has been discussed. In the other, with the prior acceptance of material incentives as compatible with socialism, the discussions go to explore the kind of incentive

mechanism the socialist countries should develop to meet the immediate requirements of the economy. The debate whether moral incentives should be the basis of motivation to work in a socialist economy, or material incentives should take over, has been discussed at length, in section II. This section also covers the problems related to incentive mechanism, such as, the success indicators etc.

It is important at this stage that the questions of enterprise autonomy and of incentives were taken up simultaneously in the various reform debates in the USSR and other East European socialist countries. But one fails to find any attempt by any of the theoreticians to determine the exact economic relationship between these two. Section III of the chapter I attempts to establish an economic link between these two aspects of the management of the economy. The link has been found through the problem of disaggregation and aggregation on the one hand, and uncertainty and risk factor on the other.

Chapter II has been an attempt at tracing the changing role of the socialist enterprises in the USSR and Hungary over the last four decades. Section I

of this chapter tries to analyse the question of enterprise autonomy in the USSR prior to 1965 - the year in which important reform measures were taken up. Although, prior to 1965, various measures were taken up to decentralise the process of decision-making the position of the enterprises in the hierarchical structure of the economy remained as it was earlier - effecting minor changes by increasing the autonomy of the intermediate level organisations like the Sovnarkhoz. Section II briefly takes up the review of the important reform debate in the Soviet Union and attempts to trace the basic character of the debate and to analyse its weakness. Section III analyses the role of the enterprises in the post reform period with a special attention paid to the exact measures of reform brought in 1965. Here, our attempts have been to trace the inadequacy of the reforms and their inherent weakness. One finds that, though the enterprises found autonomy to some extent, their scope of operation was still limited by various legal provisions. The next section indicates to the process of 'recentralisation' which had taken place in the USSR

during the seventies and the early eighties. The sections on Hungary, which follow retain the same type of historical approach and also retain the same kind of periodisation - e.g. pre-reform and post reform. The section V touches upon the basic nature of the enterprises in the pre 1968 Hungary. The basic nature of the enterprises in the pre-reform Hungary was no different from that of the Soviet enterprises in the pre-reform model and to some extent to the post-reform model. The attempts, at several points of time, at decentralisation, led only to the increase in the autonomy of the middle level organisations. But the post-reform Hungarian enterprise, the role of which has been discussed in the next section, broke away to a large extent, from the traditional framework of central planning. The new role of the enterprises, and the problem of management thereby, has been extensively discussed in this section. It also reflects upon the process of recentralisation which has^{is} supposed to have taken place in Hungary, in recent years. Careful attention has been paid to touch upon the specificities associated with the Hungarian economy.

Chapter III takes up the problem of incentives especially the development of the incentive systems in the USSR and Hungary, with reference to the problem associated with each of these systems. One can notice here, without going very deep into the problem, that the incentive systems in these two countries adopted at various points of time have never been perfect. Each incentive system created a new set of difficulties which led to planners' preoccupation with the problem of incentives. The immediate distortions in the economy had to be removed, before one ^{could} think of a long term strategy. In the USSR, the number and the type of success indicators were changed very frequently. This, ~~was~~ on the one hand, was the result of the failure of the earlier success indicators to meet the basic objectives of the plans, and on the other, it was the demand of the new national objectives finding their place in the plan. The result of the variation in the number of success indicators led to the fluctuations in the level of autonomy the enterprises enjoyed. One does not really find a systematic trend towards an incentive system which

would be ideologically and politically acceptable in the long run.

Chapters II and III combined, given a clear picture of the problem of enterprise management in the USSR and Hungary. Success indicators are not merely tools to measure efficiency - they reflected the priorities of the central planning authority and the needs of the economy. The problem would not have taken this proportion had the planners been able to disaggregate the plans to the minutest detail. But disaggregation to this level is not feasible - so the corrective mechanisms have to be applied in those countries to do away with the distortions in functioning of the economy. To solve economic problems economic methods are applied which in turn breed another series of complications. The correction of the incentive mechanism by changing the number of success indicators and by reducing or increasing the level of autonomy of the enterprise in decision-making, has been found to be a regular practice in these two countries. Neither a complete departure from the directive model was over sought, nor political and ideological methods were seriously

applied. One notices the major concern of the planners in changing the incentive mechanism and in achieving short term results. Hungarian reform, although, was radical, could not sustain the same spirit and had to return to higher level of centralisation.

The study thus tries to examine the problem at three levels - ideological, political and economic - with a view to present a comprehensive picture of the role of enterprises and incentives in a socialist economy.

CHAPTER I

A REVIEW OF THEORETICAL WORK ON THE QUESTION OF ENTERPRISE AUTONOMY AND INCENTIVES

Section I

THE PROBLEM OF ENTERPRISE AUTONOMY

The problem of enterprise autonomy in a socialist economy has generated an important theoretical debate and, probably, has drawn attention of the largest number of theoreticians, working on political economy of socialism at present. The political economy of socialism does not seem to be older than the first socialist economy in the world. Although, there was no comprehensive theory of political economy of socialism in Marx, and his contributions were confined to the building of a broad framework and principles on which the socialist economy should function, all the theoreticians in the early period of construction of socialism had to start from where Marx had left.¹

The question of enterprise autonomy had no place in Marx's writings. Lenin's ideas on the management of the socialist enterprises cannot be generalised for any time

1. Karl Marx, A Critique of Gotha Programms (Moscow: Progress Publishers, 1983).

and space. While talking on the management of enterprises, Lenin was referring to the immediate post-revolution period in the Soviet Union.² The early Marxist writers had the view of seeing the socialist economy as the anti-thesis of the capitalist economy and so the question of enterprise autonomy did not find any significant place in their discussions.³

Certain discussions in the thirties centred around the question of feasibility of central planning without the operation of market forces. Hayek, Robbins and Mises argued that for a socialist economy to function with a central decision making authority it would be necessary to solve 'millions of equations' simultaneously, which would not be possible for any planner.⁴ Lange demonstrated theoretically that in a centrally planned economy, where means of production are owned by the State, it was not

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2. V.I. Lenin, Questions of Socialist Organisation of the Economy (Moscow: Progress Publishers, year nil).
 3. For example, Bukharin and Preobrazhensky. Refer to E. Preobrazhensky and N. Bukharin, ABC of Communism (Calcutta: Century Press, 1952), Translated by P. Levine.
 4. F.A. von Hayek (Ed.), Collectivist Economic Planning (London: Routledge and Kegan Paul, 1935).

necessary to solve the 'millions of equations' to arrive at equilibrium. The decision maker can simply use the market to reach the correct price configuration by a process of 'socialist tatonnement'.⁵ Later on, when sophisticated computers were developed and their use became widespread, Lange argued that computers could solve the 'millions of equations' in a fraction of a second and therefore, the decision maker no more needed the market.⁶ Lange's model is nowhere in use. But very often it is taken as the first model of a decentralized socialist economy.

The concept of enterprise autonomy has more often taken political content. For many a theoreticians it is more a political issue than a technical one related to management of enterprises. Some of them reject the ideas inherent in this concept, associating it with 'revisionism', and some others try to justify it quoting Lenin. It is sometimes argued that even Lenin had the concept of workers' self management in his mind. But for Lenin, workers' self management and control was a "means of disorganising the enemy, rather than a serious form of socialist

5. Oskar Lange, "On the Economic Theory of Socialism" in Alec Nove and D.M. Nuti (Ed.), Socialist Economics (Harmondsworth: Penguin Books, Ltd., 1972), pp.92-110.

6. Oskar Lange, "The Computer and the Market" in Alec Nove and D.M. Nuti (Ed.), ibid., pp.401-05.

economic organisation⁷. Not only that, when he was referring to it, after the seizure of power, he had in his mind, the immediate methods to be adopted to organise a collapsing economy.⁸ This was never a prescription for management of socialist enterprises in general.

In recent times, the problem of enterprise autonomy viewed from a political angle, has found an important place in Włodzimierz Brus's 'Social Ownership and Political System',⁹ Brus studied the 'Self-Management Model' applied in Yugoslavia and the centralised system of the type in the USSR and other socialist countries in Eastern Europe (which he calls the 'etatist model') and has tried to analyse the problems involved, in both these models, in the light of the political systems in the respective countries.¹⁰ The major conclusion which he derives is that, socialisation of means of production in the Soviet Union and other European Socialist countries, has not been completed.¹¹ By socialisation of means of production,

7. Alec Nove, Political Economy and Soviet Socialism (London: George Allen and Unwin, 1979), p.76.

8. Lenin, n.2.

9. Włodzimierz Brus, Social Ownership and Political System, Trans. by R.A. Clarke (London: Routledge and Kegan Paul, 1975).

10. Ibid., pp.32-94.

11. Ibid., pp.94-95.

Brus means the society having "effective disposition over the means of production".¹² State ownership of means of production is necessary, but not sufficient for socialisation. Workers' self management must go along with it. According to Brus, the model followed in Yugoslavia has made it possible, to a large extent, to take decisions at the work place, which fulfills largely the conditions of socialisation, but at the same time, it has failed to 'depoliticise the economy' and to leave the centre to play a subordinate and residual role.¹³ On the other hand, Brus contends that the models followed in the Soviet Union and elsewhere, have not met the criteria of socialisation. 'Dictatorial' and monopolistic behaviour of the State has led to the failure to democratise the political systems.¹⁴ In essence, what Brus argues for is the democratisation of politics along with workers' self management or increased autonomy to the enterprises in their decision making. He holds that the main obstacle to the process of socialisation in these countries has been the rigid political system which

12. Oskar Lange. Quoted in *ibid.*, p.94.

13. *Ibid.*, p.92. By 'depoliticisation of the economy' Brus means doing away with all kinds of interventions of the central administration in the affairs of the enterprises. The central plan should merely guide the process of production rather than determine it.

14. *Ibid.*, p.57.

causes alienation of the workers from the process of production. The question of enterprise autonomy, according to him, should not be seen in isolation. Once the political system is reformed to introduce elements of 'democratism', the concept of enterprise autonomy automatically loses its meaning. Essentially, Brus has advanced a model of a socialist political system rather than of an economy incorporating the problem of enterprise autonomy. While giving top priority to 'democratism' at all levels, Brus has undermined the practical problems of management of enterprises in a socialist system and also discounts the role of central planning. He does not seem to be aware of the fundamental problem which a socialist economy would face, with the introduction of workers' self management of enterprises of the type existing in Yugoslavia, in the form of uncertainty and chaotic production process which would result in disproportionality among the various branches and sectors of production.¹⁵ The system following Brus's model will not be free from the 'vices of capitalism'.¹⁶

15. Maurice Dobb, On Economic Theory of Socialism (London: Routledge and Kegan Paul, 1988), p.43.

16. The problem of disproportionality among the various branches and sectors of production, the creation of a reserve army of labour, emergence of a socially 'unacceptable' output structure - all resulting from a chaotic production process and private ownership of means of production, are some of the 'vices' of capitalism.

There were often attempts to bring the question of enterprise autonomy into the ideological framework. From ideological point of view also, no consensus has been reached among various theoreticians on this problem. On the one hand, there have been attempts to reject the question of independent functioning of enterprises in toto, and on the other, various scholars have tried to develop the traditional Marxist framework and thereby use it to justify enterprise autonomy in a socialist economy.

In the line of the traditional early Marxists, Bettelheim has given more attention to the ideological side of the problem. He proceeds to develop his ideas within an analytical framework.¹⁷ He starts by differentiating 'decentralisation' from 'pseudo decentralisation'. The commonly accepted term 'decentralisation' is 'pseudo decentralisation' for Bettelheim - which is 'none other than the restoration of the market mechanism and implying thereby the abandonment of socialist planning.'¹⁸ This type of 'pseudo-decentralisation' has been practised, according to him, in all the East European 'socialist' countries and the USSR. While Bettelheim is opposed to

17. Charles Bettelheim, Economic Calculation and Forms of Property, Trans. by John Taylor (London: Routledge and Kegan Paul, 1976).

18. Ibid., p.xii of the preface.

such type of 'pseudo-decentralisation' he concedes that the virtues of socialist planning have sometimes been 'obscured' by 'overcentralisation' of the economy.¹⁹ So the 'decentralisation' which he feels necessary for the process of socialisation needs further explanation. While on the one hand, he rejects the whole idea contained in the term 'enterprise autonomy', on the other, he wants - 'effective domination of the producers over the means of production and the product'.²⁰ The 'domination of the toiler over production', the 'means' and 'results of their labour' can come about, according to Bettelheim, by putting a limit to the autonomy of the enterprises in decision making and day to day functioning.²¹ This can be done only by strengthening central planning and not by the application of 'self management' models. He argues that in the economies following the 'self management model', the enterprises are linked to each other by commodity relations - characteristic of capitalist relations of production. In an ideal socialist economy, the link between the 'productive units' should be built up through work. The commodity relations divide the workers and

19. Ibid., p.51.

20. Ibid., p.53.

21. Ibid., p.82.

leaves them only in the illusion of independence and autonomy, since "they cannot really dominate the use of either their means of production or of their products, since this is itself dominated by commodity relations".²² What Bettelheim feels is that, "it is the managers of the 'enterprises' who have the effective power to dispose of the 'means of production' and the 'products' obtained through the operation of these means by the workers."²³

While dealing with the question of enterprise autonomy and decentralisation, Bettelheim has in his mind, a transitional economy - an economy in transition from capitalism to socialism. Such a system exhibits elements of both capitalism and socialism and the relative strength of these two sets of elements determines the direction of the system, whether it will take the path to socialism or will revert to capitalism. According to Bettelheim, the introduction of commodity relations and 'autonomy of enterprises' lead to strengthening of the capitalist elements and thus may help to restore capitalism.²⁴ For him 'enterprise autonomy' is a transitional category and

22. Ibid., p.61.

23. Ibid., p.62.

24. Charles Bettelheim, The Transition to Socialist Economy, Trans. by Brian Pearce (Sussex: The Harvester Press, 1975), p.176.

it does not find its place in the post transition period when the 'enterprises' or production units lose their individual identities and get merged with the socialist production process.²⁵

While taking off from the ideological plane, Bettelheim has overlooked all the concrete problems - political as well as economic - of a socialist economy at the stage of its construction. He has an idealistic view of socialism. Throughout his book there is no mention of the problems of shortage, growth, technological backwardness etc., associated with all the socialist countries.²⁶ A serious defect in Bettelheim's analysis is his identification of the market categories of a capitalist economy with the counterpart in a socialist economy. He has failed to understand that certain categories, characteristic of capitalism, change their socio-economic content, as the system passes from capitalism towards communism. With the state ownership of means of production during the progress to communism, the 'market categories' and also enterprises play a totally different role. The 'enterprise' itself is a historical category.²⁷ At different periods of time, under different

25. Ibid., p.21.

26. Alec Nove, n.7, pp.129-30.

27. V. Cherkovets, "The Enterprise in the System of Socialist Social Production" in Problems of Economics, Vol.XII, No.10, Feb. 1980, p.4.

social environment it has taken different content. So the existence of the enterprise, per se, does not imply existence of elements of capitalism.

In effect, Brus and Bettelheim are at logger heads while dealing with the question of enterprise autonomy. Both of them argue from different grounds and neither has succeeded in providing economic substantiation to his theory taking into account the practical management problems of the socialist enterprises. The traditional frameworks of analysis, whether based on mode of production on Marxist dialectics - taking into account emerging contradictions between the progressive technical base and the old institutional superstructure²⁸ - have failed, to a large extent, to provide an approach to the study of the complex process of managing the economy and to understand the issues involved with the implementation of central planning. The shortcomings of the traditional framework of analysis have invited economists like Kornai to attempt to develop a new framework of analysis. With extensive use of the system theories Kornai has been able to show an alternative approach to the problems connected with the

28. Oskar Lange. quoted by W. Keiser, The Soviet Quest for Economic Rationality (Rotterdam: Rotterdam University Press, 1971), p.178.

overcentralisation of the economy.²⁹

Kornai builds up his model by division of different processes of the economy into real and control spheres.³⁰ The material and physical processes like production, transportation, consumption etc. fall into the category of real sphere. The control sphere takes into account the control processes like observation, information flow, decision preparation, decision making etc. This sphere embodies all the mechanisms which control the whole economy. Such control mechanisms can be distinguished by the types of organisations in the economy, the information structure, the behavioural rules and the motivation to work.³¹ Different control mechanisms work in all economic systems simultaneously (their relative strengths and the scope of operation may vary depending upon the system) - either in parallel or with sufficient degree of overlap. In a decentralised structure, the price mechanism is predominant and acts as a signalling system for control. In a fully centralised system, the directive mechanism prevails. Price and directive mechanisms are comparable to the

29. Janos Kornai, Anti Equilibrium (Amsterdam: North Holland Publishing Company, 1971).

30. *Ibid.*, pp.39-45.

31. *Ibid.*, p.35.

central nervous system of the human anatomy.³² Each of these mechanisms has some control over the different functions of the economy but they respond at a 'high level'. They may be totally irresponsible to the minor changes and may lead to distortions in the normal functioning of the economic system. So one has to take care of other mechanisms which respond to the minor and local changes. Like the autonomous nervous system, there are autonomous control mechanisms which can be used side by side with the central control methods. Autonomous control itself is a 'complex regulator' and consists of several other sub mechanisms. Kornai has traced the following sub mechanisms:

(a) Control based on stock signals: By observing the stock position, the enterprise can make necessary adjustments, by way of reducing production if there exists overstock or by increasing production in a situation of shortage, and reach the level of 'equilibrium'. Each firm can do it independently and no central directive is necessary for that.

(b) Direct connection between the seller and the Buyer: A direct relationship between the sellers and the

32. Janos Kornai and Bela Martos, "Autonomous Control of the Economic System" in Econometrics, Vol.41, 1973, p.509.

buyers can be brought about by an efficient and direct information system. They can use 'offers, advertisements, preliminary discussions and orders' to accomplish that.³³

Thus the autonomous control is a 'low level mechanism'. It is not only local in character, but also governed by the direct producer and the consumer. It assumes a high level of team work and cooperation among different agents of the economy. Kornai observes that identification of different economic agents with a particular enterprise develops an interest for the welfare of the enterprise or organisation among them. This motivates the economic agents or workers to cooperate with each other and make available the necessary informations for each other. This will not only lower the administrative and information cost, but also make production more efficient.

Here is a model of economic management from Kornai, where enterprises play a very important role, in terms of being allowed to take all current production decisions and increased use of price mechanism in a centrally planned socialist economy. By this he has not ruled out the necessity of directive mechanism. The central authority can intervene to correct any distortion created by the

33. Ibid., p.527.

price mechanism (which plays a secondary role in the centrally planned economic system) or by the independent functioning of the enterprises. The system provides for wastes - resulting from minor fluctuations in the economic activities, but can be made up by the reduction of cost in administration and information gathering.³⁴

Kornai's model is just not a model of enterprise autonomy - it is one of economic efficiency. He does not have any political or ideological consideration.³⁵ The model can be applied to a capitalist economy as well. His preoccupation with the use of economic methods for the management of the economy has left many of the political questions involved, unanswered. The choice of decentralisation or of centralisation has also been a political problem rather than an economic one alone. So the mere substantiation of a more decentralised economy with the help of the principles of 'economic rationality' and abstract model building, cannot be complete in itself.

One of the most important aspects of Kornai's model is associated with his concept of 'autonomous control'

34. Ibid., p.528.

35. His basic concern was to detect the economic forces common to all developed economic systems and to analyse their interactions. The system of ownership of means of production does not enter into his model. So the model can be called free from political and ideological considerations.

which has been discussed very often by many other theoreticians, but from a different angle. The socialist economy is not free from the 'primary uncertainties'.³⁶ Keeping this in mind, it is sometimes felt necessary to have some level of delegation of decision-making power to lower level units to make the large system move smoothly 'without too much of delays whenever something unexpected occurs'.³⁷ It can always be expected that given certain amount of freedom in decision making, the enterprises will be in a position to react much faster to any changes in local conditions than the central authority. Uncertainty makes the central decisions more prone to produce big mistakes, while the 'decentralised decisions based on uncertain forecasts are more likely to produce many smaller mistakes which partly offset each other'.³⁸ This argument favouring decentralised decision making cannot be accepted on the ground that instead of offsetting each other's mistakes the accumulated effects of all the minor mistakes may be strong enough to produce adverse results to the plans at the macro level.

36. T.C. Koopmans, Three Essays in the State of Economic Science (New York: McGraw Hill, 1957).

37. Leif Johansen, Lectures on Macro Economic Planning, Vol. II (Amsterdam: North Holland, 1978), p.389.

38. Ibid., p.390.

Of the three models discussed above, none of these is complete in itself. Whether a socialist economy should go for higher decentralisation or what role should the enterprises play in the economy cannot be determined by the politics, or certain economic principles connected with that system alone - but by a complete evaluation of the system from all angles. Most of the theoretical works have failed in this regard. Most of the theoreticians working on this issue seem to have a set of pre-conceived priorities. The difference in priorities have often led to differences in opinions also. For Brus, the priority is political democracy, for Bettelheim it is the construction of socialist values and for Kornai, economic efficiency. The differences in their opinions are evident.

'Consumers' Sovereignty' and Enterprise Autonomy:

It has been observed that in many a writings, the concepts 'enterprise autonomy' and 'consumers' sovereignty' are being taken as identical. This often leads to serious theoretical confusion. An increase in enterprise autonomy relates to a process of delegation of decision-making power from the central planning authority to those lower down the hierarchy, which may include managers or even workers in different production units or enterprises. Consumers' sovereignty is a condition in which the economic

system is governed by workers' set of inter and intra-temporal preferences.³⁹ Sometimes this is denoted by the term 'decentralisation', in contrast with 'deconcentration' which refers to enterprise autonomy.⁴⁰ Consumers' sovereignty is determined by the conditions of the market forces, the distribution and the price systems. Even under the same conditions of decision-making, the preferences of the consumers along with other market forces may play different roles. Consumers' sovereignty takes a politico-economic form and is rich in ideological content - whereas, enterprise autonomy which is related to the decision-making system and planning process more often takes a technical form and is taken as an organisational problem.

'Independence' and 'Separateness' of Enterprises:

The theoretical debate on the question of enterprise autonomy takes a different turn with the introduction of the concepts like 'independence' or 'separateness' of an enterprise.⁴¹ Such categories have come into use very frequently in the theoretical discussions in the Soviet Union. 'Independence' or 'separateness' of an enterprise

39. W. Keiser, n.28, p.181.

40. Ibid., p.181.

41. The uses of such categories are found in the writings of both Marx and Engels, but carrying different meanings.

has been defined as 'specialisation of production sectors as the unity of specific means of production and labour power', in the early stage of building of socialism.⁴² Gradually, with the development of productive forces and increasing concentration of production the existing technological framework of the production units has to be changed to accommodate co-operative relationships which, in practice, are manifested in 'associations' or 'technological production complexes'.⁴³ The formation of production complexes and associations increases the social character of labour and production process. The CPSU and the most of the pro-reform theoreticians in the fifties and sixties argued that commodity monetary relations continue under socialism, but under the new social relations of production acquires different social content. The existence of social ownership of means of production, the application of the principle of democratic centralism in the management of the economy and the use of national economic plan change the character of 'commodity monetary relations' completely. So the 'economic separation' in the socialist countries, actually, is a relative concept and the 'independence'

42. V. Cherkovets, n.27, p.5.

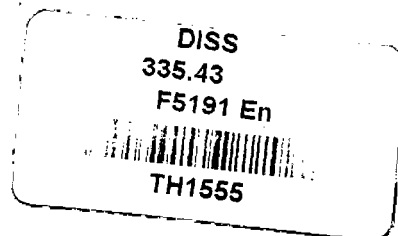
43. See chapter II for a detailed discussion on 'production associations' and 'technological production complexes'.

of the enterprise acts as a basic economic link in the complex production set-up.

The idea behind the introduction of such new categories is mostly to rationalise the state policies in the socialist countries. But such attempts at theoretical justification of the process of decentralisation in the Soviet Union, as well as, in the other East European socialist countries do not clinch the issue debated upon. The main issues involved still are whether one accepts the fact that the 'commodity monetary relations' have taken a different social content based on socialist ethics and principles, and that the 'independence' of the enterprises is not pure independence, characteristic of a capitalist economy, but a 'relative independence'. These debates cannot be settled at a theoretical level. One has to take into account the experiences of the various socialist countries, their policies and the changing role of the enterprise to have a proper understanding of the question of enterprise autonomy in a socialist system.

All the models and concepts discussed so far on the question of decentralisation and enterprise autonomy presume the existence of a centrally planned economy with state ownership of means of production. Outside the framework of central planning the debate takes a different

form. The ideas of Welfare Economics, and the general equilibrium theory thereby, are being used extensively to prove that the competitive market economy is the most efficient economic system and hence the decentralisation of decision-making is always desirable.⁴⁴ But such theories at the same time demand private ownership of means of production. These arguments are usually applied to establish a theoretical case in support of capitalism rather than to theoretically justify enterprise autonomy in a socialist system.



44. Abram Bergson, Productivity and Social System
(Harvard University Press, 1978).

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Section IIINCENTIVES: MORAL VS. MATERIAL

The problem of incentives in a capitalist economy has not drawn much attention, probably, on account of its simplistic nature. Going by the neo-classical framework of analysis, the firms will attempt at maximisation of profit and the consumers will try to maximise their satisfaction (utility) given the resource and price constraints faced by the firms and the consumers respectively. The private ownership of means of production will help the firms appropriate the profit. This works as an incentive to the firms. But the problem takes on a different dimension, when the means of production in the economy are not owned by private individuals, but, by the state. The extensive discussion on this topic has mainly been led to two directions. In one, the main question involved is whether material incentives, with or without moral incentives, ^{are} compatible with socialist principles and ethics. Here the starting point is Marx's conception of a socialist economy. In the other, the debate starts with the acceptance of material incentives as consistent with socialist ethics and tries to examine the kind of incentives a socialist economy should provide - given the specific problem of the economies. Although even today,

the discussions take into account both these two questions - in the early stage of the study of political economy of socialism, the first question was predominant - whereas, presently the second problem is much more widely discussed and debated upon.

Marx visualised that with the seizure of the means of production by the society and with the elimination of commodity production, the bourgeois value system would collapse. Individual interest and the profit of the capitalists will disappear along with struggle for individual existence.⁴⁵ Social interest will replace individual interest. In such a system the incentives to work will be non-material - moral and ideological. One explicit character of Marx's 'socialist'⁴⁶ system is that it takes for granted the existence of a high level of political and social consciousness among the people. The idea of such a system based on collectivist interest, although, is dismissed by many as romantic, has, in fact, proved to have tremendous practical implications. In fact, there have been attempts in all socialist countries to strengthen

45. F. Engels, Socialism: Utopian and Scientific (Moscow: Progress Publishers, 1978), p.76.

46. The term 'socialist' was not used by Marx in this context. 'The lower phase of communism' in Marx was later on called 'socialism' by Lenin.

and popularise socialist values and moral incentives.

The transition from capitalism to socialism is not a one-step-process - ending with the transfer of ownership of means of production from the capitalists to the Workers' State. This transition takes into account the whole process of destruction of old traditions, norms and values. Lenin himself noted this point after the Revolution in 1917 when he constantly warned the people to guard against the dangers from petty-bourgeois traditions and customs.⁴⁷ Mao also was aware of the fact that the system during the transition faces problems arising from 'the contradictions among the interests of the State, the interests of the collective and the interest of the individual, between democracy and centralising, between the leadership and the led'.⁴⁸ As also observed by others self-interest, material gains etc. which are the driving forces of capitalism, give rise to contradiction between 'individual material advancement' and 'collectivist ethos

47. Lenin, Report on the Immediate tasks of All Soviet Government to the Session of the All Russia C.E.C. in On State Capitalism During the Transition to Socialism (Moscow: Progress Publishers, 1983), pp.23-24.

48. Mao Tse Tung, On the Correct Handling of Contradictions Among the People (Peking: Foreign Language Press, 1967), p.10.

and institutions'.⁴⁹ In such a situation having the right system is not enough. What one needs are the right policies, the right methods and the correct style of work.⁵⁰ The introduction of material incentives and other elements of capitalism will strengthen the forces of capitalism and the petty-bourgeois value system. Such wrong policies will lead to increased bureaucracy. The centralist bureaucratic structure thus developed puts an end to human motivation and the idea of sharing things in common. This results in gradual erosion of the socialist values at its base.

The protagonists of material incentives argue at two levels. On the one hand, they justify the existence of material incentives in a socialist system by referring to the changing social content of the category of incentives. On the other, their attempts have been to point out the inefficiencies and mismanagement in the functions of the economics and thereby to press for a new mechanism of economic management.

In the first case they argue that material incentives play a completely different role in a socialist structure

49. E.L. Wheelwright and Bruce McFarlane, The Chinese Road to Socialism (New York: Monthly Review Press, 1970), p.149

50. Mao Tse Tung, Peoples' Daily, Nov. 26, 1956, Peking.

than what it does under capitalism. So the identification of material incentives under socialism with its counterpart under capitalism is wrong. To substantiate their argument they very often refer to Lenin who had suggested the application of material incentives for workers during the immediate post-revolution period in the Soviet Union. It is true that Lenin had in his mind the idea of rewarding workers for detecting fraud and delay on the part of the rich and the capitalists and of distribution of profit made by the socialist enterprises, among the workers.⁵¹ But most of the theoreticians who quote Lenin, fail to understand in what context Lenin talked about it. The period in the Soviet Union was characterised by the contradiction between private capitalism and petty bourgeoisie on one hand and state capitalism and socialism on the other.⁵² The survival of socialism and state capitalism at that time depended largely upon the strength of the workers in the socialist sector of the economy and their support to and co-operation with the forces of socialism. The profiteer, the commercial racketeer were the main 'internal' enemies of the economic measures of Soviet

51. Lenin, n.2, p.20.

52. Lenin, "Left Wing" Childishness and the Petty Bourgeois Mentality in n.47, p.39.

Power.⁵³ So to destroy them and to advance socialism it was necessary to mobilise the working class against them. It could be possible only through sufficient encouragement to the workers and when necessary by rewarding them. In fact, the whole idea of providing material incentives to workers was a short term policy, arising out of the specific conditions of that time.

The second line of arguments for introduction of material incentives emanates from the indication to the changing conditions of the socialist economies, the problems of intensive growth strategy, waste, irrational plan construction, shortage of consumer goods, poor quality of goods produced, labour indiscipline, technological backwardness, failure to fulfil plan targets etc.⁵⁴ They argue that such problems are the result of lack of interest and initiative in work on the part of the workers and managers of enterprises. The ideological and political commitment to the socialist system, they say, is not enough for developing interest for work among the people. It is to everyone's knowledge that every system of economy has its own problems. So it is not difficult to believe

53. *Ibid.*, p.39.

54. Alec Dove, The Economics of Feasible Socialism (London: George Allen and Unwin, 1982), pp.50-54.

that the socialist economies in the world also are faced with serious economic problems. What cannot be ascertained is to what extent the application of material incentives can be used as a corrective measure for the shortcomings to be eliminated totally. Whatever may be the rationality behind such an argument, a tendency to overemphasise the role of material incentives in the economy, which was common with most of the participants in the reform debates, has misdirected the theoretical discussions on this issue.

Incentives and X-Efficiency: A Neo-Classical Analysis:

Certain shortcomings in and the weakness of the reform debate in the Eastern Europe and also in the USSR, to some extent, led to increased popularity of the subject in the western academic circle. A large number of writings appeared on the question of incentives mostly using the neo-classical framework and decision-theories. A neo-classical defence for material incentives is found in a model developed by Leibenstein. He has used the concept of x-efficiency which he calls organisational and motivational efficiency. He argues - "Firms and economies do not operate on an outer bound production possibility surface consistent with their resources. Rather they actually work on a production surface that is well within that outer bound. This means that for a variety of

reasons, people and organisations normally work neither as hard nor as effectively as they could. In situations where competitive pressure is light, many people will trade the disutility of greater effort, of search, and the control of other peoples' activities for the utility of feeling less pressure and of better interpersonal relations. But in situations where competitive pressures are high and hence the costs of such trades are also high, they will exchange less of the disutility of the effort for the utility of freedom from pressure etc. Two general types of movements are possible. One is along a production surface towards greater allocative efficiency and the other is from a lower to a higher one that involves greater degrees of x-efficiency".⁵⁵ So what the centrally planned economies need, going by this argument, is increased x-efficiency, in other words, the development of material incentives and increased autonomy of the enterprises. The problem with such an argument is that it again undermines the defects in planning and always concentrates on the micro level irregularities and attempts to seek micro level solutions. Although Leibenstein's model is a strong case in support of material incentives, there has been no

55. H. Leibenstein, "Allocative Efficiency Vs. X-Efficiency" in American Economic Review, Vol.LVI, No.3, June 1966, pp.394-95.

attempt on his part to study the concrete problems faced by the socialist economies, different incentives systems existing there and thereby to relate these to the expected behaviour of the workers and managers and analyse it vis-a-vis the problems of planning. Most of the theoretical works by the neo-classical economists have been to study the behaviour of an enterprise manager, faced with certain bonus forming indicators. The works of Bonin, Weitman and others have varied substantially from each other so far the specific structures of the models are concerned. But all these models assumed single output and single plan target set for them. Certain results derived from these models have analytical and theoretical significance, but the strict assumptions about the products, plan targets and behaviour of the enterprise managers make the models highly unrealistic.

The official positions of all the East European Socialist countries and of the USSR to justify the introduction of material incentives do not discount the role of moral incentives. They believe that material incentives are important, but they are not the only and definitely not the principal 'creator of labour activism'. It is held that creative impulses, professional pride, aesthetic feelings, political and ideological commitment

and many other factors play important roles in motivating the workers to work. Such behaviour plays much more an important role especially for those who are at responsible position in decision making.⁵⁶ The negligible of such social and psychological factors in the management of the economy has, in fact, oriented the studies on economic management towards more intensive use of economic methods and of material stimuli. In most of the writings on reform of economic mechanism the potential of economic methods and of the use of material incentives have been highly exaggerated. The economic reform of 1965 in the USSR shows such characteristics. The reform measures seemed to ignore the potential inherent in the "human factor".⁵⁷ The limited scope of material incentives can be seen even when one talks about job satisfaction of workers. Some sociological studies in the Soviet Union have revealed that job satisfaction is determined, to a large extent, by the "content of labour itself and the creative element that it contains".⁵⁸ Even Liberman, the leading advocate of reforms in the Soviet Union noted the importance of

56. R.G. Karagadov, "Economic Regulation and Income Policy", Problems of Economics, Vol. XX, No.1, May 1977, p.5.

57. Ibid., p.5.

58. V.A. Volkonskii, "Economic Interests and the Economic Mechanism", Problems of Economics, Vol. XX, No.6, p.5.

moral incentives and its workability in the more efficient running of the economy.⁵⁹ Many a times the selfless work of the members of the Communist Party of the Soviet Union and of other mass organisations are quoted.⁶⁰ Their extensive contribution to the efficient running of the economy is the outcome of their strong political and ideological consciousness.

The debate on incentives - whether moral or material - ended with the wide acceptance of the fact that the material incentives must play more important a role in a socialist economy, but it should always be allowed to go side by side with moral incentives. Whatever attempt one makes to justify the compatibility of material incentives with socialism, the ensuing debate has clearly demonstrated that there exists a conflict between socialist ethics and immediate social needs in all the East European Socialist countries and in the USSR. The debate ended in a compromise. Once material incentive was considered as compatible with socialist ethics and principles the problem for most of the planners was how to evolve an effective material incentive system.

59. E.G. Liberman, Economic Methods and the Effectiveness of Production, Reprinted in Problems of Economics, 1974, pp.28-29.

60. Alec Nove, Soviet Economic System (London: George Allen and Unwin, 1977), pp.112-14.

An incentive system mainly specifies the criteria by which the contribution of various economic agents to the social process of production to be measured and the performance may be related to rewards. It determines,

- i. Which agents should get the rewards;
- ii. The size of the rewards;
- iii. The relationship between the rewards and the performance or success indicators;
- iv. Which indicator should be used to measure performance.

In the reform debate the first of the above mentioned issues was settled with fairly wide acceptance of the fact that all the employees in the enterprises should get something as rewards to their performance. The issues raised by (ii) led to some controversy. But the actual debate centred around the issues raised by (iii) and (iv).⁶¹

The main controversy, in the debates on incentives centred around the acceptance of profit as an indicator of performance. Once profit is used as a determinant of the size of the bonus fund and a measure of the efficiency of the enterprise, then the aim of the enterprise should be to maximise profit. This has led not only to an

61. Martin Cave and Paul Hare, Alternative Approaches to Economic Planning (London: The Macmillan Press Ltd., 1981), p.63.

ideological debate, but also raised certain technical questions. The opposition to the adoption of profit came from those who identified it with an element of capitalism and believed that the principle of maximisation of profit is against the socialist ethics. This argument was refuted by differentiating profits under socialism from capitalists' profit. At a slightly more technical level the question was raised whether profit maximisation would be compatible with social needs. If the production structure is almost completely determined by the central planning, then this problem will not take any serious dimension. But at the same time, given the technological structure of production, at the absence of a very efficient mechanism of income regulation, the profits and thereby the incomes of the enterprises may vary substantially enough to create high income inequality among the enterprises, which itself again goes against the ethics of socialism. But once income regulation is taken more seriously then the results of using profit as an indicator will be much lower than will be expected. At a very technical level, the ideas behind the introduction of profit as an indicator and of income regulations will be contradicting each other. Income regulating methods may not allow for the obtainment of all the fruits of adoption of profit as a determinant

of incentives, yet a compromise can always be reached by accepting the maximisation of profit within a certain limit, at least to do away with the ill effects of such a policy.

Merit of various performance indicators cannot be judged from a purely theoretical ground. The taste of pudding lies in eating, so ^a careful survey of their implications in different socialist economy will show which of the indicators can be considered as useful, if not perfect, and which of the theoretical propositions hold true.

SECTION IIIINCENTIVES AND ENTERPRISE AUTONOMY:
AN ECONOMIC MODEL

The question of enterprise autonomy and incentives are closely connected in a centrally planned socialist economy. In such an economy the enterprises have to follow the instructions given to them by the higher authorities - instructions prepared by the central planning body with or without consultation with the enterprises or other lower bodies. While preparing instructions, the central planners are faced with certain difficulties.

The number of products in an economy is often very large. There are millions of different products in a developed economy, if these are fully disaggregated. One can imagine how big a task for the central planning authority to plan the production and distribution of all the goods and thereby issue instructions to various enterprises and organisations, in every detail. The task is theoretically not impossible, but for all practical purposes it is certainly not feasible. There are two major problems in it. The first is the problem of information and the other is the actual preparation of the disaggregated instructions. The second problem can be tackled only when the first is solved. One can think of a perfect

information system - all the informations are gathered and processed in no time and necessary instructions are prepared accordingly. But in reality such an information system does not exist anywhere - let alone, the centrally planned socialist economies. So even the basic requirements for instructions to be sent to the enterprises in a totally disaggregated form are not met in any of the socialist countries. But even when one assumes such a perfect information system the problem of disaggregation does not get solved. The preparation of plan instructions in detail for every activity in the economy is again not an easy task. Given the existing methods of computation and other techniques of planning, the task is almost impossible in the socialist economies. One can imagine, e.g., a road transport enterprise, in a socialist economy receiving instructions in a fully disaggregated form.⁶² The instructions should clearly indicate which of its hundreds of lorries will take how much of load, which good to carry, where to go, which route to follow, the time it should take, etc. etc. Even a very efficient planning body is not expected to go into such details.

When a perfect information system is assumed, it is

62. Alec Nove, n.54, p.73.

not meant that all the informations received by the central planning body are correct. What was assumed that the informations from its primary source, in every detail, are received instantaneously. This excludes the possibility of informations being manipulated at the lowest level. For example, the stock of a particular raw material in an enterprise may be correctly known to the enterprise manager. But for variety of reasons he may not give the exact figure to the central planners. So the problem of information arises, not merely as a result of some kind of a communication gap, but it takes into account number of other factors related to the behaviour of the managers and workers of enterprises. The behaviour of different economic agents is not predictable in general. It depends largely on the objective conditions in which the particular economic agents take the decision (whether to give the correct or the wrong information). So certain behavioural and motivational aspects come to play important roles in economic decision making, whether at macro-level or at micro-level. The problem of disaggregation thus becomes more complex. Even when the disaggregation is made possible, in some way or the other, one cannot be sure whether the basis of such disaggregated plan instructions is itself correct. So more sophistication of the information machinery and planning techniques does not solve

the problem completely. So the behaviour of the various agents in the economy is important for the planning process as a whole - whether the plan instructions are disaggregated or not. The question of incentives originates exactly here.

Moral incentives may solve the problem. But when it comes to material incentives, then the problem becomes much more complicated. Certain basis has to be determined on which the incentives can be awarded. The method should be related not only to certain common behaviour of the various economic agents, but also to other objective conditions of the economy.

The problem posed above is related to the construction of plans only. Here the link between the question of enterprise autonomy and incentives is not very clear. But the link becomes very clear when one comes to the process of plan implementation. Even while assuming a proper feedback of informations by the lowest strata in the planning and management hierarchy, can one be guaranteed of a desired implementation of the plans? Even theoretically it is not possible. When the plan instructions are in a totally disaggregated form, for the plans to be implemented, certain conditions are to be satisfied. Either there should exist a very high level of socialist

and moral values among all the agents in the economy so that whatever is directed is implemented in the interest of the society, or there has to be some kind of negative incentives in the form of punishments etc. so that the economic agents are forced to work as they are required.⁶³

If none of these two conditions is satisfied, to get the plans implemented in the desired manner, the planners have to resort to material incentives to the workers. So even under strict central planning, in the absence of sufficient ideological or political commitment of the workers, the material incentives must play an important role.

When the plan instructions are aggregated the enterprises are given more autonomy. Taking the earlier example, the road transport enterprise may receive plan targets in tonne-kilometres instead of a set of instructions in detail. The scope of the enterprise's own decision making is enlarged. The enterprise, in such a situation, faces a number of alternative methods to arrive at the given plan target(s). It is upto the enterprise to decide upon which of the alternatives to choose. It can achieve the plan fulfilment by either increasing the mileage by taking

63. Assuming no other external condition to influence the economic processes.

longer routes or by increasing the load at each trip. It is not necessary for the enterprise to choose the best of the alternatives available - the best in the interest of the society. There are two problems involved in it -

1. The problem of plan construction at the enterprise level. Here the question of enterprises choosing the best alternative is taken care of;
2. The problem of plan implementation. Here the question of enterprises fulfilling the plan target comes in.

Let us take the second problem first. This is related to the basic nature of central planning. Whether the plan instructions are aggregated or disaggregated, one cannot guarantee fulfilment of the targets by the enterprises. There has to be some mechanism to achieve plan fulfilment, besides, moral incentives.

There are two aspects in the first problem. Firstly, to arrive at the best alternative the scope of the given enterprise has to be maximised, within the framework of central planning. Otherwise, it may not be possible for the enterprise to choose the best even if it wants. This demands freeing of the enterprise from certain bureaucratic constraints. Secondly, the plan targets (which are related to material incentives) or the success indicators are to

be evolved in such a way that the enterprise can at least come close to the best possible alternative. This is precisely the reason why throughout the reform debates in the USSR and other East European Socialist countries the question of enterprise autonomy and of incentives were discussed simultaneously. The pre-occupation of most of the participants in the reform debate with the secondary adjustment of the economic mechanism through the changes in success indicators has blurred the problem related to freeing the economic enterprises from the central planning authorities. On the one hand, the reformers were interested to reduce bureaucracy, and on the other, they were looking for a proper success indicator so that the optimum results of the economic processes are ensured. Very little was discussed about a departure from the traditional methods of planning and, as has been discussed earlier, the question of real enterprise autonomy was never discussed seriously and independently. As a result of the extraordinary importance given, the success indicators have become the key link between the question of autonomy of enterprises and the problem of incentives.

Risk, Uncertainty and Incentives:

The other element which serves as the link between enterprise autonomy and incentives is uncertainty. The

various economic agents, whether in a capitalist system or in a socialist one, do not know in advance the different future 'States of the World' - "...good or bad harvests, favourable or unfavourable conditions for various export commodities on the world market, various conceivable technical innovations taking place or not taking place; oil to be found or not found, houses and forests to be destroyed or not destroyed by fires or other catastrophes, favourable or unfavourable conditions for fishing, plenty of rain or too little rain for the reservoirs for hydro-electric power production, good or bad weather for vacations..."⁶⁴ The secondary uncertainties of Koopman's type can substantially be avoided in a socialist economy, but this type of primary uncertainties cannot be avoided even under strict central planning.

The major source of uncertainty typical in a socialist economy can be identified as follows -⁶⁵

- 1) Errors in Planning;
- 2) Changes in central plans;
- 3) Incorrect assessment of market demand;

64. Leif Johansen, n.37, p.391.

65. J. Wilczynski, Profit, Risk and Incentives under Socialist Economic Planning (London: Macmillan, 1973), p.50.

4) Changes in trade and relation with the capitalist countries.

Now, whatever may be the cause of uncertainty, if the developments in the economy are such as to demand alterations in the plans, it will be interesting to note in which way the plans and other economic processes are going to be adjusted to the changing situation. When the plan instructions are totally disaggregated, (a hypothetical situation in the context of the present day socialist economies) a minor change in any of the economic variables will ask for large scale restructuring of the plan instructions. But when the plan instructions are in aggregate terms the unanticipated changes will demand alterations of the plan targets and economic policies at the macro-level. The enterprises, accordingly, change their plans in the light of the new set of plan targets and other instructions. The enterprises in such a case act within the framework of autonomy allowed for by the central planning structure. This type of an adjustment is possible only when the central planners instantaneously can react to the changing situation and are well aware of the same. But there may be cases when certain changes may not even catch the attention of the central planners immediately, or the changes may be of such nature that only certain

micro-economic processes are affected and no immediate intervention of the central planning authority is called for. In such cases the enterprises on their own can take the necessary steps for adjustment. The situation is similar to the one which demands 'autonomous control', in Kornai.⁶⁶ For the enterprises to react to the changing condition, two important requirements are to be met -

- 1) The enterprises must be given sufficient freedom to adjust the economic processes under their control, independently (i.e. without the permission of the central planners) to the changes.
- 2) The workers must be provided sufficient incentives so that such adjustments are carried out in the desired way.

To meet any uncertain change in the economy, the enterprises to react to that must have sufficient reserve, or at least command over the resources. The more centralised in the allocation of resources, less is the freedom of the enterprises. The mere legal provisions for independent action of the enterprises are not enough. It needs substantial change in the structure of management. The other

66. Kornai, n.29, pp.39-45.

related problem is the risk involved in choosing the best alternative, when the enterprise is faced with a number of choices. The risk involved in such a choice situation may not be common everywhere, or even may not be big enough to influence the decision of the enterprises. But it definitely plays an important role when the non-fulfilment of plan deprives the managers and workers of their bonus. The risk associated with the introduction of new techniques of production, developed as a result of innovations may be so high as to retard the technological progress of the economy. In a capitalist economy the expectation of profit of the capitalists neutralise this risk. There has to be some mechanism in the socialist economy also for the same. Not only that some reward should be given for taking risk and getting positive results, but the incentive mechanism should also see that the enterprises do not suffer as a result of risk taken and failing thereby. What type of an incentive mechanism will incorporate a solution to this problem is something which will be discussed later on. But the point that we are trying to make is that in a risk involved choice situation or in an uncertain situation, for the enterprises to act in the most desired way, a combination of freedom to the enterprises and incentives to the workers must be ensured in a centrally planned socialist economies of the type of the USSR or other East European Socialist countries

CHAPTER IX

ENTERPRISE AUTONOMY IN THE USSR AND HUNGARY

SECTION I

'THE COMMAND ECONOMY' IN THE USSR

The industrial management and planning system¹ in the USSR and other East European Socialist countries have undergone different phases of development as required by the development of the productive forces and the complexities arising due to the increasing size of the economy.

Prior to 1957, the Soviet industries were administered mainly on a vertical basis. The centrally-controlled economy was commonly known as the 'Command economy' in Western circles.² The most important feature of such an economy is that, here the 'commands' or the directives from above are transmitted down the hierarchical ^{structure} ~~set~~ as substitute for market forces in linking the various agents in the economy. Though the extent to which 'commands'

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1. There is no clear cut demarkation between planning and management - both at the macro and micro levels, especially in the centrally planned economies.
 2. Moshe Levin, Political Undercurrents in Soviet Economic Debates, from Bukharin to the Modern Reformers (Princeton: Princeton University Press, 1974) pp.113-14.

used to govern the economy in the Soviet Union is debatable, the period upto 1953 showed that the 'Commissariats' or ministries had extraordinary power in decision-making. Their decisions used to influence the units even at the bottom of the vertical structure. The power of the ministers increased further during the last phase of Stalin's leadership, i.e. from 1945 to 1953.³ The general characteristics of the economy as outlined above does not shed much light on the role of enterprises. So a close look into the administrative apparatus and the planning process in the Soviet Union is necessary.

The Administrative Structure of the Soviet Industries prior to the reforms in 1965:

As stated earlier, the administrative mechanism in the Soviet Union has developed historically. Although the major reforms were carried out only after 1965, yet the reform measures taken earlier had substantially changed the management mechanism in the economy.

The ministry or the 'Commissariat' was at the helm of all economic affairs. Within each ministry there was sufficient division of work. Each ministry had to supervise a branch territorial glavk (or a trust or a combine),

3. Timothy Dunmore, The Stalinist Command Economy - the Soviet Apparatus and Economic Policy (London: The Macmillan Press Ltd., 1980), p.7.

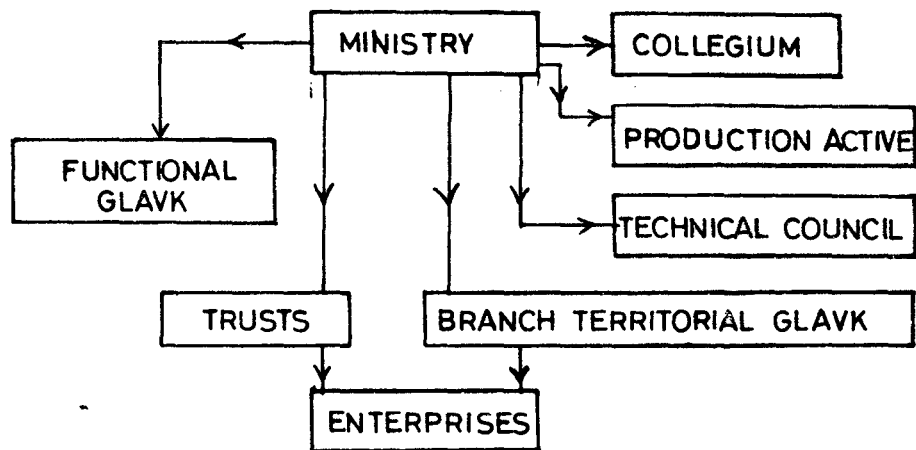
several functional glavki (e.g. transport, supply and marketing) and staff bodies like Minister's Collegium or his technical council. The officials of the branch ministry also had to look after many other bodies which were outside the branch ministry but within the framework of the Council of Ministers.

The direct administration of the enterprises was formally the responsibility of the ministry and the branch territorial glavk (or the trust or the combine). But at the same time there were other state bodies, even outside the ministry, which had sufficient control over the enterprises. The following schematic diagram will give an idea of the administrative system of the economy during the '40s and the early '50s.⁴ (see Diagram 1.)

The structure of the administration provided little for the enterprises to play any independent role. But even then it will be incorrect to say that all the economic decisions were taken at the centre (Politbureau of the CPSU, Council of Ministers) and the 'commands' determined the course of the economy. The Soviet bureaucrat - a manager of an enterprise or any intermediary in the

4. Ibid., p.7. Based on A. Arakelyan, Industrial Management in the USSR, pp.108-10.

ORGANISATIONAL STRUCTURE
OF MINISTRY OF FERROUS
METALS IN 1947



LINES OF SUBORDINATION →

Diagram -I

Source: Dunmore, n.4.

hierarchy - had sufficient opportunity for influencing the decisions taken at the centre. This was made possible by the fact that the managers of plants and other officials at the same level involved in planning and administration, played the key role in providing information to the planning authority. So the decision of the central planners, to quite some extent depended on the information provided by such officials and it was exactly here that they found sufficient manoeuvrability.

With the growth of the Soviet economy, the disadvantages of such a Pyramid-type administrative structure became clear. With an increasing number of enterprises, all over the country, coming under the jurisdiction of the same ministry, efficient administration of the economy became impossible. In an attempt to bring efficiency and specialisation, the Soviet Government increased the number of ministries and directorates.⁵ By 1955, the number of economic ministries had grown to 53, in comparison to 18 in the year 1932.⁶

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5. For example, the Ministry of Machinery was split into three separate ministries dealing with heavy machinery, medium machinery, and machine tools respectively. Philippe J. Bernard, Planning in the Soviet Union (Oxford: Pergamon Press, 1966), p.109.
6. The process of increase in the number of ministries was not a continuous one. In fact, at times there were attempts to cut down the number. But in general over a period of time there was a tendency of, as well as, actual growth. Ibid., pp.109-10.

At the time when the specialisation was being tried, some other problems appeared. There was a strong tendency for the enterprises in different industrial sectors and within the same region to be 'sealed off into water-tight compartments'.⁷ The results of ministries becoming 'self contained with their own suppliers and customers' was massive cross hauling of goods.⁸ The lack of coordination and weak horizontal linkages between enterprises was quite prominent. This led to lack of specialisation at the enterprise level. For example, in Kharkov, the engineering enterprises came under 20 different Union Ministries.⁹ The lack of coordination among various ministries on one hand, and the total dependence of the enterprises on the ministries on the other, created confusion in the administration of the enterprises. To correct such maladies the central committee of the CPSU in September 1953 and in July 1955 took steps to give wider power to the Republics in various fields. The number of products subject to centralised planning and allocation was reduced. The process strengthened the role of the

7. Ibid., p.110.

8. Ibid., p.110.

9. Ibid., p.110.

Republics - but the position of the enterprises remained as it was earlier.

The process of 'deconcentration'¹⁰ or regional decentralisation continued. The major step was taken in 1957 with the creation of Sovnarkhosh. Prior to 1957, a feeling had generated that the enterprises be given more autonomy in decision making. But the creation of Sovnarkhosh left this question untouched and concentrated on creating some intermediate links between the ministries (or central administration) and the enterprises. The idea of the reform was to bring the administration into closer contact with the enterprises and to increase participation by the people in the management of the enterprises. For that, the planners envisaged the administration of the enterprises to be based on territorial principles.

With the reforms of 1957, the large scale enterprises¹¹ came directly under the control of the Sovnarkhoshy. The small scale enterprises were under the administration of the local Soviets, towns and Oblasts. The authority of

10. The term 'deconcentration' has sometimes been used to mean a process towards a market economy.

11. The large scale enterprises were those with more than two hundred workers.

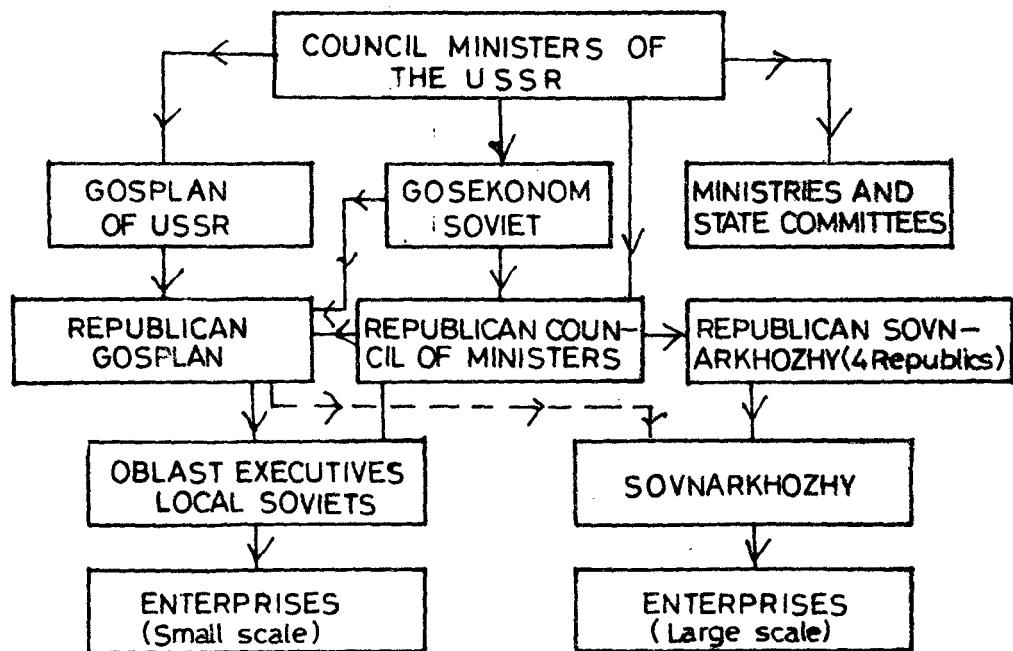
soon
 the Sovnarkhozhy/extended over large number of small enterprises also.¹² The Sovnarkhozhy experiment also, like some other earlier reforms changed the organisational structure of the industry as a whole leaving the position of the enterprises unchanged. The following schematic diagram will give an idea of the administrative structure of industries during the period 1960-1962. (See Diagram II.)

It can be noticed that from 1952 there was a decreasing tendency of the proportion of enterprises coming directly under the control of the Union Ministries. But by the end of 1956, this tendency was no longer prominent. After the reforms in 1957 and upto 1962, no major change in the role of enterprises was visible.

The second stage of the Sovnarkhozhy experiment started with the creation of USSR Sovnarkhozhy in 1962. This was another attempt to reshuffle responsibility and power among the various decision-making bodies at the top level. This also failed to bring about any remarkable change in the position of the enterprises, as is evident from the following schematic diagram. (See Diagram III.) After the 13th March 1963 decree the small scale enterprises

12. This was only the general trend. There were cases of small scale enterprises going out of the control of the Sovnarkhozhy.

ORGANISATIONAL STRUCTURE OF
INDUSTRY AND CONSTRUCTION
1960-62



LINE OF SUBORDINATION →

Diagram - II

SOURCE: Bernerd, n. 5.

SIMPLIFIED DIAGRAM OF THE
ORGANISATIONAL STRUCTURE OF
INDUSTRY AND CONSTRUCTION
AFTER THE DECREE OF
13TH MARCH 1963

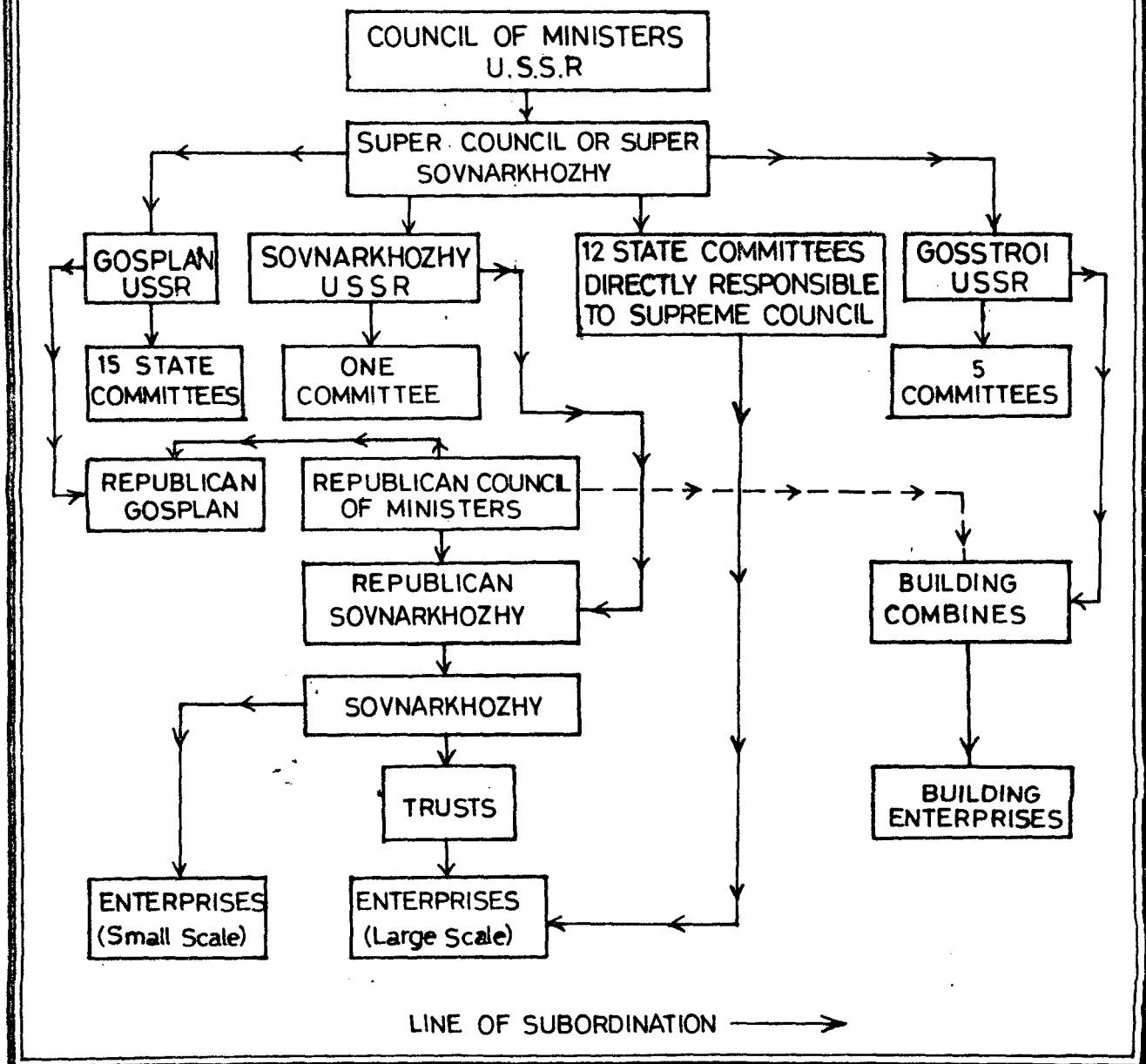


Diagram - III

Source: Bernerd, n.5.

also came under the Sovnarkhozy.

The Process of Planning in the Soviet Union
prior to 1965 Reforms:

The general procedure adopted for plan construction upto the mid-1950s in the Soviet Union was as follows:

To start with, a set of general directives on plan is prepared by the Gosplan. This is then sent for approval to the Politbureau of the Party and the Council of Ministers. This is then discussed with the individual ministries and the Union Republic Council of Ministers to construct the draft plans for their own sectors and regions within the general framework of the plan provided to them. The draft plans for different regions and branches are then sent back to the council of ministers and Gosplan for further consideration. The Gosplan then prepares the final draft of the detailed plan before it is placed before the Council of Ministers for approval. Different stages of discussions used to involve various processes of bargaining. Here the individual ministries, Gosplan and the Council of Ministers and all other different bodies involved in the plan construction try to exercise their authority and assert their points of view through the medium of bargaining. The ministries

had sufficient legal freedom in the plan implementation process. So far as the microeconomic policies of the enterprises are concerned, the ministries had a major role to play. The directives which are handed down to them from the higher planning authority used mostly to be in a broad framework - related to the different targets to be achieved. Such targets were set for the branch as a whole. This had to be disaggregated for various enterprises. The targets for the enterprises were set mainly by the territorial branch glavk. This required final approval of the Council of Ministers. But the number of targets set by the branch territorial glavk was so large that the Gosplan, the Council of Ministers or any other higher authority found it extremely difficult to keep eyes on the minute details of the plan. The branch territorial glavk used to set the following targets for the enterprises:¹³

- i. Utility and assortment of the output to be produced.
- ii. The amount of labour, total wage bill and the level of productivity to be achieved.
- iii. The unit cost of production to be achieved.
- iv. The level of raw materials to be used by the enterprises.

13. T. Dunmore, n.3, p.9.

v. The initial allotment of fixed and working capital.

The distribution of the raw materials was not completely centrally determined. Gosplan (after 1947 Gossnab) drew up plans for material supply only for important outputs and scarce materials. The number of output for which there existed central allocation of raw materials increased two folds between 1940 and 1953. But 'unfunded production' still formed 50 per cent of total production. The normal figure used to be around ³⁰ per cent.¹⁴ The share of unfunded production was largely determined by the bargaining strength of the enterprises and the ministries, within the limits fixed by the central planning authority.

The transport system was very tightly controlled by the centre. Enterprises or other lower bodies did not have any kind of formal control, at least in the 1940s. But the labour recruitment policy gave much freedom to the enterprises and ministries. The Gosplan did not have any control over the allocation of labour.

With the creation of Sovnarkhozhy (1957) and USSR

14. Ibid., p.11. 'Unfunded production' was defined as the output of industries for which there was no central allocation of resources. So the increase in 'Unfunded production' at a time when the number of products with central allocation of resources was increasing implies growth in the volume of output of those goods which had no central allocation of resources at a rate faster than the others.

Sovnarkhozhy (1962) the process of plan construction changed considerably. Over the period of time, these organisations were given more autonomy in plan construction and implementation. In the planning process the enterprises had just a consultative voice. The proposals of the enterprises had a secondary status so far as the Gosplan was concerned. Within such a strict framework of central planning, it may appear that the enterprises and even branch ministries did not have any effective say. But in practice the branch ministries and even enterprises had some 'de facto' freedom in decision making.¹⁵ The number of 'commands' given to the branch ministries was so large and the number of targets set for the enterprises so high that the ministries and the enterprises could not possibly achieve all. So at lower levels of management there was a tendency to drop some of the targets or neglect some of the directives so as to be able to fulfill others. Enterprise managers could choose which of the targets to be reached and which are to be neglected. This informal behaviour of the enterprise managers and other middle level bureaucrats used to be very common in the '40s and early '50s.¹⁶ The autonomy

15. Ibid., p.8.

16. Ibid., p.8.

which the enterprise enjoyed during the '40s and early '50s in the Soviet Union was to some extent in the area of finance.¹⁷ They could take steps necessary to keep costs of production down and to increase profits. But this autonomy was confined to the methods of utilisation of resources. The decisions regarding what was to be produced and how, were centrally taken. In the late '50s there was a trend towards decreasing the number of categories subject to central planning and emphasising of plan elaboration at the enterprise level. It was reported that, a large number of specialists were sent to production sites to train people to draw up plans at local level.¹⁸

The role of the enterprises was significant in the second stage of planning, i.e. in the preparation of the national supply plan. The enterprises were allowed to make contracts connected with the supply of inputs required by them, immediately after the completion of their draft plan. These orders which established strong horizontal links among the enterprises were not mere formalities. These were taken into consideration. For long term

17. Alec Nove, An Economic History of USSR (Middlesex: The Penguin Press, 1980), p.265.

18. P.J. Bernard, n.5, p.74.

planning the part played by the enterprises was, however, much more restricted than in the case of annual plans.

SECTION IITHE REFORM DEBATE

After the failure of the Sovnarkhozy system of management of industrial enterprises, the CPSU ushered in a discussion on basic planning reforms. The resurgence of such a discussion was not unexpected. The deteriorating conditions of the management and the material incentive system had drawn attention not only of the economists but also of the political authorities. In the reform debate the opinions of the participants were sharply divided on the question of decentralisation of the economy - one group demanding greater centralisation and asking for improvement in the planning system and the other, advocating for increased enterprise autonomy and augmentation of the use of material incentives. The advocates of greater centralisation suggested the use of more advanced electronic computers to make it possible to calculate in physical terms the total needs of the various enterprises. Fedorovich went on to say that the "inadequate methods of computation is the cause of failure to process huge information" which was the key problem for the planners in the Soviet economy.¹⁹

19. Quoted by Eugene Zaleski, Planning Reforms in the Soviet Union, 1952-60 (Chapel Hill: The University of North Carolina Press, 1967), p.73.

So instead of going for decentralisation, the optimum variants of the economy at all levels could be drawn up by using computer programmes. For the exponents of greater centralisation, it was impossible to see the enterprise level planning in isolation from the central planning. It was contended that the autonomous decisions taken by the enterprises on wages, employment investment, costs or profits would jeopardise the national planning and dismantle the long range structure of the economy. There were also fears, at that time, of rising local interests and indiscipline with the introduction of a decentralised system of management. At the ideological and political level, the possible growth of elements and vices of capitalism, was also produced as a case in support of centralisation.

The advocates of decentralisation led by Liberman, suggested partial decentralisation of decision making as a means to strengthen central planning.²⁰ The principle of centralism, as they understood, does not incorporate the assignment of tasks to the central planners which can be locally resolved. Liberman held that the central

20. Among the other advocates of decentralisation the names of Kantorovich, Konchikov, Birman, Bunich and Vasy are important.

planners would have a command over the fundamental proportions in production distribution and consumption in the economy by using various tools of planning like prices, finance, budget, accounting, major investments, incentives etc. He also specified that the goals for labour productivity, employment, wages, profits, investment and introduction of new techniques should be determined directly by the enterprises themselves.²¹ None of the major economists, excepting Kantorovich, rejected or accepted Liberman's proposal in toto. Kantorovich defended Liberman's model outright - while at the same time suggested the use of mathematical optimisation models to make the central plan more sophisticated.²²

It was noticeable in the Soviet Union that the pronouncements in favour of greater independence for enterprises were more frequent. These were expressed sometimes in general terms and sometimes in specific ones. The specific pronouncements differed from one another. Very often the distortions created by the supply and the distribution system and also by prices and markets,

21. E.G. Liberman, "Plan, Profit and Bonuses", Problems of Economics, Vol.VIII, No.3, July 1965, p.3.

22. L. Kantorovich, "Mathematics and Economics", Problems of Economics, Vol.VIII, No.5, September 1965, p.15.

were the focal points of discussions. So a major part of the reform discussions was confined to the role of markets. It can be seen from the positions held by some of the official participants in the debate, Brezhnev maintained "The party will continue to strive to see to it that our economic policy ensures the further development of industry, and particularly its most progressive branches...the expanded production of consumer goods. ...The study of supply and demand has moved into a leading place among the practical tasks that face Soviet economists. The question is now being raised of the constant observation of the market in Soviet trade...of changes in the demand for consumer goods".²³ Kosygin noted that there was an "urgent need to compile plans for the production of consumer goods on the basis of orders from customers". He went on to say that "the transition to such a system of planning will undoubtedly be a step forward... we shall proceed toward planning on the basis of orders placed by the consumers...in all branches of the national economy".²⁴ This is a clear indication of the direction the reform took. In fact, the reform debate took too many

23. L. Brezhnev, Ishvestia, 6 November, 1964.

24. A. Kosygin, Ishvestia, 9 December, 1964.

issues simultaneously and the question of enterprise autonomy was blurred by an overemphasis given to the improvement of the incentive system and of the market mechanism.

SECTION IIIENTERPRISE AUTONOMY IN THE USSR
AFTER THE REFORMS OF 1965

After the interesting reform debate the Soviet leaders went ahead with certain changes in the methods of administration of the economy and the planning procedure. The more radical ideas emerging from the reform debate, envisaging fundamental changes in the economy, were all rejected.

The Statutes on the Socialist State Production Enterprise, approved by the USSR Council of Ministers on October 4, 1965, went for a major shake up in the administration of enterprises by doing away with the *sevnarkhozhy* and bringing the enterprises back to the control of ministries. But so far as the enterprise was concerned, the reform measures took into account four major aspects of management:

1. Enterprises' finance;
2. The system of incentives;
3. Planning autonomy of the enterprises; and
4. Inter enterprise relations.

The official position adopted clearly stated that the operation of the enterprises should be based on a combination of 'centralised direction' and 'economic

independence' and initiative on the part of the enterprise.³⁵ The phrase 'economic independence of enterprises' is quite misleading in the sense we use it. In the Soviet context or as understood from the Soviet official writings, it means enterprises having separate balance sheets (implying separation of one enterprise from another) and some kind of a relative autonomy in their day-to-day decision making. The enterprises were to follow the guidance from the superior bodies and function under the framework of the national economic plan. The reforms defined the responsibilities of various organisations and enterprises clearly and each organisation and enterprise was made responsible for its own obligations and not of others.

One of the important aspects of the reform was that the enterprises, henceforth, went for complete cost accounting. Cost accounting was not new to Soviet enterprises - but the necessary freedom and legal provisions required by the enterprises to implement it fully, was missing. The new reform measures took special care to see that the cost accounting could be implemented successfully. So far as the autonomy of the enterprises

35. Statutes on the Socialist State Enterprise, Approved on October 1965 by the Council of Ministers, USSR. Reprinted in Problems of Economics, Vol. VIII, No. 9, January 1966, p. 3.

in the planning process goes, the area of independent operation of the enterprises increased substantially. Previously a fairly detailed plan used to be given to the enterprises which had reduced the enterprise's initiative and the scope of decision making. The Soviet enterprises had some kind of liberty in financial matters. Even then, the enterprises used to receive financial plans from above with full particulars. This procedure was changed completely and instead, certain indices were fixed for the enterprises. These indices were profit, profitability, payment to the budget and appropriation from it.²⁶ The enterprises were given complete autonomy on matters regarding utilisation of incentive funds and in fixing norms for bonus to various employees. They were also made eligible to resort to bank credit on their own, provided that they guarantee its proper utilisation.

Over a period of time the question of plan elaboration at the enterprise level had been emphasised upon by various planners in the USSR. The Statutes on enterprises of 1965 took care of this problem and allowed the enterprises to draw their annual and long term plans covering all their

26. V. Garbusov, "Finances and Economic Stimuli", Problems of Economics, Vol.VIII, No.10, Feb.1966,p.3.

aspects, in accordance with the fixed indices. These plans used to be in details and covered the annual technical plan, annual production and financial plan and quarterly and monthly production plans. The director of the enterprise was made responsible for final approval of such plans. The enterprise was given total autonomy in fixing qualitative and quantitative plan targets for the various shops, departments, sections, production units and other structural subdivisions.

The most important aspect of the reform was that there was a serious attempt on the part of the planners to strengthen the horizontal linkages among the enterprises. This was done by a delegation of decision-making power to the enterprises on distributional matters. In fact, from the early '50s onward the planners in the Soviet Union had been trying to reduce centralised delivery plans. Prior to the year 1958 there were three different categories of products. The most important of the products used to be called the 'base products' - the number of which increased till 1952 and stood at 2000. In 1958, the number was brought down to 760.²⁷ For each of these products a production and consumption delivery schedule

27. Bernard, n.s, p.83.

was drawn up and were allocated in accordance with the central supply plan. The group of products, which were of lesser importance was allocated by the central supply directorate or by the appropriate branch ministry. The last group of products was not subject to central allocation and its distribution was the responsibility of the respective Republican Ministry or Sovnarkhozy. The distribution of the products of a large number of local industries was left to the discretion of the enterprises.

In April 1958, this classification of products was revised and more products came to be distributed by the enterprises themselves. But even then, bureaucracy and interference from the higher authorities prevailed in preparing the delivery plans of the enterprises. The reform of 1965 tried to free the enterprises from such bureaucratic practices. The enterprises producing consumer goods acquired the right to organise production on the basis of orders received from the trading organisations and the contracts concluded with them. The enterprises, however, were not free to choose their trading partners. Prior to the reforms there were certain experiments with the 'direct link' system by which the customer could be brought closer to the producer. This experiment with two enterprises - one in Moscow and the other in Gorky,

had done away with the involvement of the trading organizations and tried to build up direct link between the enterprises and the stores.²⁶ The enterprise's freedom was not unlimited. Although the two enterprises could enter into contracts freely, only a few other enterprises had the right to enter into contract with these two pilot enterprises. The number of success indicators for these two enterprises was limited to two - the total volume of marketed production and total product. The actual level of autonomy provided to these two enterprises is still not very well known, but one can be sure of the fact that the managers of these two enterprises enjoyed more independence than the ones in other enterprises at that time. The results of the direct link experiment was judged to be encouraging. In spite of the various difficulties encountered by the enterprises, the experiment was extended to many other areas. In fact, it was planned to extend this method of management to all other enterprises.

With the new reform package coming in, the above process was brought to an end. The new reform proposals

26. E. Zaleski, n.19, p.122.

did not incorporate any of the methods tried at distributional autonomy of enterprises. The abolition of the 'direct link' experiment with the implementation of the new reform measures brought the enterprises back to its old position on distributional matters. But at the same time the enterprises were given the rights to accept orders from other organisations for manufacturing products or for execution of some jobs provided that the job or the level of output is above plan and that it is produced from raw and other materials or production wastes. It was also to be kept in mind while signing such contracts that the extra production does not affect the plan adversely. The terms and conditions of the contracts depended upon the type of product. For goods which were distributed by a superior body, the terms and conditions of the contract used to follow the given Distribution Acts. But if the product is not centrally allocated, then the contracts are concluded by the enterprise independently by agreement with the respective purchasing organisation or enterprise.

The new Statutes allowed the enterprises to sell any material or equipment acquired through local purchase at its own discretion. The surplus equipment which

included transport provisions, instruments, tools, stock, raw and other materials, fuel etc. for which there was not any allocative order from the higher authorities refused to take any responsibility even after being informed formally, could be sold by the enterprises as they wished. The sums of money obtained from such sales were to remain with the enterprises. The enterprises were allowed to lease out to other organisations and enterprises, equipment which was lying temporarily unused. Enterprises could thereafter lease out even buildings and other structures lying temporarily idle at rents fixed by the appropriate superior body. Whereas in most of the cases of leasing, the permission of the higher authorities was not required - the case of transport equipment was an exception. The enterprises were granted the right even to sell products to any other body if the product does not find a market through the orders for allocation.

As far as the current production decisions are concerned, the position of the enterprises improved slightly. The most important of the newly acquired rights obtained by the enterprises was the right to produce goods of higher quality than required by the State standards. They also could approve, by agreement with the customer (organisation or enterprise), the

technical specifications for the products which had no state standard fixed for it or other technical specifications by higher authorities.

The 1965 reforms made it possible for various enterprises to fix prices of different products which were not subject to the approval of the superior body, following the general framework of existing legislation, by agreement with the customer enterprise. The prices of all other products were centrally determined. The inadequacy of the price system became conspicuous, especially when profit (sales) became the major factor determining the size of bonus fund. The huge income differentials among the enterprises, created by profits, necessitated an urgent reform of the price system in 1966-67. The goal of the reforms was to build a price structure in such a way that the majority of the enterprises could earn a 'normal profit rate' and a 'few of the best and the worst earned a bit more or less in proportion' as their work varied from the 'normally operating enterprise'.²⁹ It was realised that if the profit differentials are too

29. Joseph S. Berliner, "Planning and Manage" in Abram Bergson and Herbert Levine (Ed.), The Soviet Economy: Toward the Year 2000 (London: George Allen and Unwin, 1963), p.355.

large, then prices would play a more active role in decision-making. The idea at that time was to see that prices could not be used as an allocative device and plans continued to be primary in the economy. The price reforms thus reestablished the central plan as the chief allocative mechanism.³⁰ But on the question of new and higher technology products, prices were fixed in such a way that a certain profit differential is always maintained. In such cases by allowing prices and profits to play a more active role, the scope of operation of the central plan was limited.

We have already noted earlier that the enterprises had some autonomy in adopting labour recruitment policies and wage determination. The new reforms enhanced the level of autonomy in this regard.

Some Post Reform Developments (1985-1988):

Production Associations: The merger of groups of enterprises to form 'production associations' or 'technological production complexes' is one of the important developments in the management of the Soviet economy. It was understood by the Soviet planners that the existing structure of

30. Ibid., p. 356.

management was not conducive enough to sustain a high rate of technological progress and to form the output structure considered best from the point of view of consumers' preference and planners' priority. In most of the Soviet writings, the formation of the production associations is seen as characteristic of 'developed socialism' and is rationalised ideologically.

The formation of the production complexes was a move towards horizontal integration of the various enterprises, but at the same time it changed the vertical links of the management system noticeably. A large number of decisions which were earlier taken by the enterprises came to be taken by the production associations. In one way it strengthened the role of central planning by reducing the autonomy of the enterprises, and on the other, relieved the higher bodies in the management and planning hierarchy, like the ministries and Gosplan, from their responsibilities to implement plans and from day to day decision making. So from the point of view of the ministries it was a process of 'decentralisation', whereas for the enterprises it was none other than a process of 'recentralisation'.³¹ Although the history

31. A.C. Gorlin, "Industrial Reorganisation: The Associations" in Soviet Economy in a New Perspective (Washington: Govt. Printing Press, 1976), p.172.

of the production complexes and the science production associations goes back to 1960, the specific forms of these organisations have been acquired only in the '70s after the Enactments on All Union and Republic Industrial Associations (1973), the Production Associations (1974), the Science Production Associations (1975). The number of production associations also grew from 606 in 1970 to 3670 in 1977.³² Their share in the volume of realised output of industries increased during the same period from 6.7 per cent to 44.3 per cent.³³ The number of enterprises also grew from 2564 to 16516.³⁴ Of all the enterprises brought under the associations in the year 1977, 9403 enterprises lost their legal identity as independent enterprises and became production units of the associations.³⁵ The status of the enterprises was thus delegated to one of the shops of a new 'super enterprise'. The number of enterprises not joining the associations stood at 33005 in 1977.³⁶

32. V. Cherkovets, "The Enterprise in a System of Socialist Social Production", Problems of Economics, Vol. XXII, No.10, Feb. 1980, p.7.

33. Ibid., p.7.

34. Ibid., p.7.

35. Ibid., p.7.

36. Ibid., p.7.

The industrial production complexes had gained tremendous popularity among the Soviet planners. They are planning to bring all the enterprises under the associations. But inspite of this increased attention to the concentration of production, it has been noticed in the Soviet Union that certain enterprises are provided with some extra autonomy in decision making.³⁷ In any way, this does not seem to be a general practice. Some enterprises, not under the associations are given special freedom in decision-making for specific reasons.

The 1977 reform made it very clear that planning should have priority over management in the economy. The planners' concern was to improve the planning mechanism and to bring it to a level where enterprise managers have only to play a residual and subordinate role. The other aspect of 1979 economic reform was its re-emphasis on regional planning. Territorial industrial complexes were formed in the line of the production associations. The regional ministries were given extra freedom. The idea behind the whole process was to increase the autonomy

37. Victor and Allen Perlo, Dynamic Stability: The Soviet Economy Today (Moscow: Progress Publishers, 1980), p.281.

of the regions. On certain aspects it had some similarities with the Sovnarkhozny experiment of 1957 but the scope of the 1957 experiment was much wider.³⁸

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30. The points of similarity between the Sovnarkhozny and the production associations are as follows:
1. Largely self-sufficient organisations;
 2. Regional character;
 3. Position in the management and administrative hierarchy. Both these organisations had occupied middle level positions.

SECTION IVENTERPRISE AUTONOMY IN HUNGARY
BEFORE THE REFORMS OF 1968

The centralised model of planning was in use in Hungary as in other East European Socialist countries before the reforms in 1968. The socialist state in Hungary directly decided on the tasks and the direction of the economic development and also allocated the resources that secured the realisation of these objectives. The economic system in Hungary exhibited all the basic features of a 'command' type economy. The enterprises played a passive role in Hungary as it did in the Soviet Union, in planning processes and in economic decision-making. The central decision-making authority not only took the macro economic decisions which concerned the national economy as a whole, but also the major share of the decisions concerned with enterprise management. The enterprises had the role of executing the plan directives and to achieve the plan targets; the plan indices centrally determined and disaggregated to a certain level for the enterprises. Like in the USSR, there were attempts at various points of time to bring about some decentralisation in decision making. In 1954 and 1957, the number

of compulsory indicators was brought down.³⁹ Simultaneously certain other measures were adopted to increase the autonomy of the enterprises in the area of wage formation. The scope of the enterprises' functioning was further widened by the introduction of the profit sharing system in 1959, the more flexible price system, formation of technological development fund and the introduction of the change on capital goods in 1964.⁴⁰ Hungary, like

39. Lajos Ficzere, The Socialist State Enterprise (Budapest: Akademiai Kiado, 1974), p.38.

40. J. Wilczynsky, Socialist Economic Development and Reforms: From Extensive to Intensive Growth Under Central Planning in the USSR, Eastern Europe and Yugoslavia (London: Macmillan, 1972), p.50.

other East European Socialist countries, followed the Soviet price system. The centrally determined rigid price system narrowed the scope of the enterprises to come into direct contact with the customer (may be another enterprise or cooperative enterprise). Leave alone the restricted role of the market and the inefficiency exhibited thereby, the pre-reform price system was a fetter on the development of horizontal linkages among the enterprises and on the development of foreign trade. The 1957 price reform in Hungary did not fundamentally change the way in which the prices were to be calculated. The basic idea of the reform was to make them correspond more closely to the cost of production. On the question of organisation of enterprises certain changes were made in the early '60s. This was with the evolution of certain larger organisations, developed by amalgamating number of industrial enterprises and co-operatives, often called trusts. This was a step again, following the Soviet pattern, to strengthen the middle level of the administrative and management apparatus.

Whatever be the nature of the reforms carried out and the level of seriousness in which the reform measures were implemented, all the attempts at increasing

enterprise autonomy did not result in departures from the 'directive model' of management and planning of the economy. The corrective measures adopted in the form of partial reforms could not change the position of the enterprises in any significant way. The economic problems arising, whether at macro or at micro level, on account of the restrictive role of the enterprises in decision-making, could not be solved without going for a fundamental change in the management and planning system. The theoreticians and planners soon entered into a wide ranging debate on certain key problems of the economy. In the debate, the individual opinions of the various participants varied. But the outcome of the debate in Hungary was a general acceptance of the fact that the reform should be a radical one.

SECTION VENTERPRISE AUTONOMY IN HUNGARY
AFTER THE REFORMS OF 1968

In January 1968, Hungary introduced a comprehensive economic reform to overcome the growing problems of management of the economy. The nature and the scope of the Hungarian reforms of 1968 (known as the NEW ECONOMIC MECHANISM) was radically different from the Soviet reforms of 1965. It also had nothing so in common with the market socialist model of Yugoslavia adopted in 1965.⁴¹ Fundamentally, the reform was to abandon the 'directive model' as a whole. Instead of setting obligatory plan targets for every economic activity in detail, the reform proposals envisaged the use of economic regulators (prices, taxes, duties, foreign exchange rates, interest, incentives, market supply and demand etc.) in accordance with the 'commodity market economic environment'.⁴² The model

41. The Yugoslav model is common known as the 'market socialist model' or sometimes as the 'self management model'. Here the enterprises are completely responsible for the production and investment decisions. Except for the fact that the means of production are owned by the State and the workers have effective control over it, one finds it difficult to trace any significant difference between the Yugoslav model and any system under capitalism following some kind of an indicative planning.

42. L. Csapo, "Central Planning and Guided Market Model", Acta Oeconomica, Vol. I, Nos. 3-4, 1966.

generally described as the 'guided market model' was an attempt to use market forces to improve allocative efficiency and the system of incentives, within that framework, where all the major directions of the economy are determined by the central plan.

Reform in the Planning Process: One of the most important results of the NEM (New Economic Mechanism) was the changing position of the enterprises in the economy. This was effected primarily by changing the planning procedure. After the reforms, the annual plans were abandoned. The medium term plans, which covered a period of 5 years became important in the economy. The five year plans were divided into two parts - the 'natural' section gave an outline of the development of the economy in terms of the macro aggregates, and the 'operative' section consisted of statement of policies, especially the details of the economic regulators.⁴³ To reduce rigidity of the plans the uncertainty factor was taken into account. The progress of the plans, in the implementation process, was studied carefully and for that short term plans, ranging from 3 months to 2 years, were

43. G.R. Denton, New Economic Mechanism? Economic Reforms in Hungary (London: Broadsheet), p.9.

introduced. The performance of such plans could reflect the medium term plans so as to help change the plan whenever necessary. These changes in plans would include the readjustment of the economic regulators.

When the 'directive model' was scrapped, the 'commands' of the higher authorities lost their position as the link between the plans and the decisions and plans of the individual enterprises. In the new system this link was established through the use of economic regulators, e.g. monetary and credit policy, budgetary policy, price policy, infrastructure investment, central control of the establishment of new enterprises, employment and wage regulations, export and import regulations etc. There was another set of regulations under the general category of 'direct government directions'. This gave unlimited discretionary power and the right to intervene in any of the operations of the enterprises. Such discretionary powers in the hands of the central authority reduced the actual independence of the enterprises.

The abolition of the annual plans and the obligatory indicators, the Hungarian enterprises could adjust their production structure to the changing circumstances on their own. According to the new arrangements only the

wage rate was to be fixed centrally - the size of the wage bill was to be determined by the enterprises themselves. Although the wage rate was fixed, the wage drift which was common even under the old system continued under the new system of economic administration.⁴⁴ The effect of wage drift was experienced, in fact, more strongly. The new system enabled the enterprises to have more control over the labour recruitment policy and the labour market in general. The system of direct allocation of labour was abandoned and the workers were allowed to change their employment on their own. With substantial freeing of the labour market the effective scope of operation of the enterprises enlarged.

Investment and Credit Reforms: In the investment front also, with the introduction of the new credit policy, sufficient flexibility in the use of funds, generated within the enterprise and in the availability of credit was brought in. The system of financing of investments was as follows. 50 per cent of the working capital of the enterprise was financed from its own fund. 25 per cent

44. Ibid., p.11.

The tendency for wage earnings to exceed wage rates gives rise to wage ~~xxxxx~~ drifts which is measured as the difference between wage earnings and rates. The difference will consist of bonuses, overtime allowances and other monetary payments made to the workers.

of it was through medium term credits. The medium term loans were of two types - one was given to those foreign trade enterprises which were short of working capital in January 1968 and the other was given to the enterprises for the purchase of raw materials, for payments of labour etc. Another 12½ per cent of the working capital was acquired from 'long term passifs', i.e. the profit of the enterprise due to the national budget but not yet paid. The last 12½ per cent was in the form of short term credits.⁴⁵ The enterprises had to pay a 7 per cent of interest on short term credits in addition to a 5 per cent

45. Ibid., p.12. The actual share of the various sources forming the Enterprise Development Fund or the Production Development Fund used to be different from the pattern envisaged. The following table will indicate that

PATTERN OF ENTERPRISE DEVELOPMENT FUNDS BY MAIN SOURCES (in percentage)

<u>Sources</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
Depreciation	49.6	33.8	31.5	31.1
Profits	5.0	29.2	27.1	30.5
Other sources	9.9	9.2	10.7	8.8
State Support	17.4	13.5	12.0	12.5
Credit	18.1	14.3	18.7	17.1

Sources: J. Hüsser and M. Mandel, "The Investment Decision-Making System in Hungary", Eastern European Economics, Vol. XI, No. 3, Spring 1973, p. 39.

charge for the use of all the working capital.⁴⁶ The effective rate of interest thereby was raised to 12 per cent. The credits were not automatically renewed. For every 90 additional days an additional interest at the rate of 1 per cent had to be paid.⁴⁷

Before the reforms, the enterprises used to receive an initial endowment of working capital. After the reforms the enterprises became completely self financed with their working capital. Any increment to the existing level of working capital had to come either from their own profit fund or through credits. The fixed capital is also financed ^{in a} similar way - either from enterprise's own fund or from credits. The medium term credits are sanctioned usually for a period of three years, which can be extended to five years in special cases. The medium term credits for augmentation of fixed capital is related to the development fund, i.e. the credit is given to the development fund of the enterprise and has to be repaid from it. Certain provisions for long term credits were also introduced. But these were meant for those activities which were recognised as essential to

46. Ibid., p.13.

47. Ibid., p.14.

the economy as a whole. The eligibility for applying for such loans was determined by whether the project has a prospective return of 20 per cent or not.

At the macro level after the reforms, about 16 per cent of all the fixed and working capital of all the enterprises was financed from credits.⁴⁸ 34 per cent of it was obtained from enterprises' own funds and about 50 per cent was derived from the national budget, mostly in the form of investments in the individual major projects.⁴⁹

Upto 1957, the increase in the working capital of the enterprises was to be financed by the State budget. The general practice was that the increased working capital had to be derived from the funds created by accumulation. The accumulation of all the enterprises was directed to the State budget leaving the enterprises with no source to finance any increase in the working capital. Some changes were made after 1957 allowing the enterprises to retain a part of their net income in order to create funds for profit sharing and for

48. Otto Gado (ed.), Reform of the Economic Mechanism in Hungary Development 1968-1972 (Budapest: Akademiai Kiado, 1972), p.22.

49. Ibid., p.22.

development. The development fund was too small in comparison with the total investments in working capital. Thus the role of enterprises on augmentation of working capital was very limited and the State budget continued to be the main source of finance for this. The increase in fixed capital was completely financed from the State budget. So the enterprises had absolutely no autonomy in this regard.

Thus the 1968 reforms brought in a significant change in the direction of increased enterprise autonomy by making them completely dependent on themselves for financing fixed and working capital. The new credit and investment policies enabled the enterprises to decide on the amount of stock necessary for implementation of their own production plans. It is true that the level of independence in decision making by the enterprises was limited by the size of the development fund, i.e. by the level of resources the enterprises had with them. Yet, the increase in the size of the enterprise's own fund itself led to increased autonomy. There were two other important measures introduced in 1968 which widened the scope of enterprises' independent decision making. The first is the introduction of inter-enterprise crediting system which allowed the enterprises to lend their excess

working capital to other cooperating enterprises. The other measure allowed the enterprises to grant commercial credits to one another in connection with the delivery of goods or performance of services. Such credits were financed from resources lying idle temporarily. These two measures strengthened the horizontal ties between two different enterprises. Since no norm was fixed by the central authority regarding such inter-enterprise credits, the enterprise was completely responsible for such financial agreements with any other enterprise.

There is no doubt of the fact that the investment and credit policies increased the autonomous role of the enterprises to a large extent. But even then, if one observes carefully, certain constraints on the independent functioning of the enterprises become visible.

The credit system which we have been discussing so far, cannot be seen in isolation from the credit policies.⁵⁰ Central objectives of economic policies are always to be

50. Ibid., p.25. By credit system we mean the kind of credit relationship which exists between an enterprise and a financing body. It takes into account the terms and conditions of credits and other technical issues involved in granting a loan, by credit policy. We have a macro view of the financial system which is linked to the national policy objectives.

in the forefront. To implement the credit policies, the Government very often had to intervene in financial matters of the enterprises. The scope for such interventions was already there even in the reform model. The banks by granting or denying short term credits, could force the enterprises to accept the pattern of behaviour which the banks felt to be correct. The ability of the enterprises to pay the interest was not the sole criterion of determining the creditworthiness of an enterprise. Various other restrictions used to be imposed on the enterprise if its performance was not upto the mark. The credits are more often subject to a detailed set of economic measures determining even the size of the development fund and the uses that can be made of them. Such discriminatory interventions can be compared with the company law, labour law and fiscal and monetary policies in the West.⁵¹ The principles of self-financing, although considered as correct, the excess in self financing is also damaging to the economy. It was held by number of Hungarian economists that the unrestrained self-financing led to rise in the price level and prevented the implementation of certain policies important

51. Ibid., p.25.

for the economy.⁵² To do away with such problems often the higher authorities had to intervene. The legal power of the ministers to intervene in the functioning of the enterprises was embodied in one of the clauses of the fourth 5-year plan.

Clause 56. (2). "When certain objectives of the national economic plan cannot be realised with a suitable alteration of the regulating system, and if such action is motivated by the interest of the national economy the ministers concerned shall use their legal power and issue orders to the state enterprises".⁵³

Immediately after the reform of 1968, the ministers and other supervisory bodies remained passive observers of the affairs of the enterprises. But gradually their role became more active and their interventions more frequent.

Price Policy and Price Reforms: The drawbacks of the earlier price system was very clear. The idea of the 1968 price reforms was to give more freedom to the producers, as well as, to the customers in decision making regarding

52. There is another group of economists who prescribe increase use of self financing.

53. Fourth Five Year Plan: Hungary. Quoted in Ibid., p. 37.

price formations by allowing the market forces to play a more important role. The wholesale price system was made flexible. Only the prices of the most important raw materials were centrally determined; others were either centrally limited or freely determined by agreement between suppliers and customers. The reform started with 23 per cent of floating or free prices (before the reforms the corresponding figure was 14 per cent of the total turnover) 50 per cent of fixed prices (for all these the downward movement was allowed) and 27 per cent of limited prices (permitting both downward and upward movement to the extent of 5 to 10 per cent).⁵⁴ The relative freeing of prices for large number of goods was a step forward to increase enterprise autonomy.

Also, the Hungarian reform of 1968 made the enterprises free to adjust wages and salaries according to their own requirements within certain aggregate limits on income. The reform put a 4 per cent limit on the yearly growth of aggregate personal incomes in the enterprises and 2 per cent yearly limit in budgetary institutions. The procedure to be followed for the

54. Radoslav Selucky, Economic Reforms in Eastern Europe, Political Background and Economic Significance (New York: Praeger Publishers, 1972), pp. 140-41.

distribution of profits among various employee groups was to be determined by the individual enterprises. In the foreign trade front also the enterprises found a larger area of independent decision making.

There has not been any notable change in the economic mechanism and thereby in the role of the enterprises in Hungary in the '70s and early '80s. Number of changes have been made, but not at the cost of any fundamental change in the model adopted in 1968. The reforms of 1968 have many a times been questioned. It is sometimes contended that the termination of plan instructions and the introduction of the profit interest in enterprises failed to cause any fundamental breakthrough either in efficient utilisation of resources or in maintaining a stable demand and supply relations with the consumers.⁵⁵ The idea of the reforms as mentioned earlier, was to create competition among the enterprises. But in practice the competition could not grow as was expected on account of the development of 'monopoly' enterprises. Given the size of the Hungarian domestic market, any big enterprise could become monopolistic. The fact that such

55. Marton Tardos, "Enterprise Supply and the Market", Eastern European Economics, Vol. XII, Nos. 3-4, Spring-Summer 1983.

'monopolies' were institutionalised heavily, their influence on the market was much more than the monopolies in the free market situations. For competition to develop the smaller Hungarian enterprises needed more autonomy. It has been found^{that} the freight traffic monopoly of Masped was destroyed by the smaller ambitious enterprises like Mahart, Hungarocamion etc. when they were allowed more autonomy.⁵⁶ Excellent results were achieved when small ancillary units were permitted to produce spare parts on their own to fill the gaps in the commercial vehicle programme and to eliminate the bottlenecks in production.⁵⁷ But at the same time certain enterprises behaved contrary to the expectations of the central planners calling for interventions of the superior bodies. So the process of decentralisation could not be carried out further. At times whatever autonomy was provided to the enterprises had to be curtailed to correct the distortions created by the irresponsible behaviour of the enterprise management. After the abolition of the directive model, some of the Hungarian enterprises were faced with a new set of problems. Berend has noted:

56. Ibid., pp.26-48.

57. Tamás Bauer and Károly Attila Soos, "Inter-Firm Relations and Technological Change", Eastern European Economics, Vol. XXI, Nos. 3-4, Spring-Summer, 1983, pp.84-104.

"The enterprises still had no market and price incentives, while on the other hand, they were hindered in their operations by too few directives. Thus the enterprises were beset by difficulties in obtaining the necessary raw materials and in delivering the goods produced... Even the foreign trade enterprises, always more interested in a more elastic system, now strove for a completely detailed plan for export. Otherwise, they would not have been assured of being adequately supplied by the producing firms".⁵⁸

This explains to some extent why the new reforms model could not be applied consistently in Hungary. State interventions increased in the day to day affairs of the enterprises. The role of the central plan was strengthened and the beginning of a reversal in the system of functioning of the economy was experienced. This is not to say that recentralisation was experienced by all the enterprises. In fact, in number of cases the successful enterprises were provided with sufficient autonomy in planning and management.

58. Ivan Berend, "The Historical Background of the Recent Economic Reforms in East Europe", East European Quarterly, Vol.2, No.4, Sept. 1969, p.67.

CHAPTER III

THE DEVELOPMENT OF THE INCENTIVE SYSTEMS IN THE USSR AND HUNGARY

SECTION I

THE SOVIET CASE

Once it was decided that material incentives should be introduced in a centrally planned socialist economy it becomes necessary to develop a workable method by which the work of an individual or of an enterprise could be evaluated. The search for an effective indicator of work performance has been the main problem before the planners and the theoreticians in the Soviet Union and other East European Socialist countries over the last three decades. Probably the hunt for an appropriate performance indicator would not have drawn much attention if it could have been possible to issue plan instructions in a highly disaggregated form, thereby needing the enterprise just to follow these. The initiative and the sense of responsibility on the part of the enterprise managers or workers would not have, in such a case, played any important role. But, as discussed earlier, not only that the plan instructions could be issued in such a form, but also was the fact that every new aggregated

indicator of success introduced, was associated with a unique set of problems.

Material incentives in the USSR are of two types. In one, it takes the form of collective consumption. The fund is used to improve cultural and living conditions of workers and production. The other goes as bonuses to the workers, managers and other people. This part depends upon the work performed by the individuals. Prior to the reforms of 1965, the collective consumption was done mainly from the 'enterprise fund', which used to be created from the fixed deductions from planned and above planned profits in enterprises working on the principle of planned profit, and from planned and above planned savings in costs in enterprises working on the basis of planned loss. The rates of deductions were different for different enterprises and so the actual size of the enterprise fund used to vary substantially from enterprise to enterprise. As a method of incentives the collective consumptions did not play an important role in the economy on account of its insignificant size. In 1955, the enterprise fund came only to 0.5 per cent of the total wage fund.¹ In 1956 there was virtually

1. E. Manevich, "The Principle of Personal Incentives and Certain Wage Problems in the USSR", Problems of Economics, Vol. II, No. 3, May 1959, p. 25.

no change in it.² But the differentiation of income among the enterprises posed other problems. The enterprises which were profitable thrived from such methods for the formation of incentive funds. Not only that, since the incentive was linked to the quantitative fulfilment of plan, many enterprises made it a practice to lower the plan targets, so that they could easily achieve the plan targets and claim the funds. The enterprises which performed exceptionally well but had high plan targets suffered in the process. In 1956, in the bicycle industry, production rose by 18.5 per cent, labour productivity by 16.8 per cent and costs reduced by 4 per cent. But as they set a very high plan target, the actual production fell short by 1.6 per cent. As a result of this the bicycle industry was deprived of forming an enterprise fund.³ In fact, it was the confectionary industry which had a better deal as an outcome of setting lower plan targets. The other factor which led to differentiation of income among the enterprises was related to the changes in the structure of prices. When the prices of some commodities were suddenly slashed,

2. Ibid., p.25.

3. A Zayetsev and F. Dronov, "Problems of Material Incentives in the Government Owned Enterprises", Problems of Economics, Vol.II, No.3, May, 1959, p.3.

the profit-size of the enterprises producing these commodities used to fall resulting in smaller size of the enterprise fund. Such discrepancies had a negative impact on the development of initiative among the enterprises to produce more and more efficiently. Leaving aside other technical flaws in such a method of forming the incentive fund, the way it was implemented led to the gross misuse of the autonomy the enterprises were given. Not only the enterprise fund, but because of the same reasons, the bonus fund for the workers was also affected.

The bonus was the major part of the incentives in the USSR. Bonus used to be paid over and above the wages of the workers and salaries of the managers and others, for quantitative fulfilment or overfulfilment of various plan targets. The number of success indicators was more than one. But the bonus forming indicator was mainly the gross output index. This index was used by different enterprises in different ways. Not only that, the bonus system itself had no uniformity. As a result of the multiplicity of the bonus system the same person could get bonus from more than one source.⁴ Besides

4. Ibid., p. 36.

quantitative fulfilment or overfulfilment of plans, bonuses used to be paid for other specific quantitative production indices, e.g. for savings of raw materials, materials, fuels, for increasing labour productivity, introducing new equipment etc. The bonus system in the USSR in the fifties could determine the dynamics of industrial production, plan fulfilment, volume of the social product and the national income, the level of labour productivity, the relationship between the various sectors of production. But even then, the basic problems remained unaltered. At the stage of extensive growth of the economy, the indicator contributed significantly. But as a macro-economic policy measure, it failed to utilize the productive forces of the economy properly which ultimately led to tremendous waste. The details of macro-implications of the use of this indicator is beyond the scope of this study. But the micro irregularities it brought in, had serious implications to the planning process and the management of enterprises.

The method used to calculate the gross output in current prices was not free from difficulties. The marketable or marketed output was estimated at current prices at which it was sold. But the same

procedure could not be followed for non-marketable output. The price for any non-marketable output was computed partly by the cost of production and partly by the average price at which it was realised. This non-uniformity made this index unacceptable even on theoretical ground. Especially for construction and other works, which have long gestation periods, in determination of work in progress, the enterprises had enough scope for manipulating this index to draw higher amount of bonus and fund for them.

The applicability of the gross output index was limited by the fact that it was difficult to make comparisons between different types of physical outputs. The extravagant use of raw materials irrespective of costs and production of goods of inferior quality, made the indicator more unsuitable. There are number of cases of enterprises producing extra heavy goods where weight was considered as the index. Different other cases of irrationality were observed with other forms of gross output indicator. Even when the value of output produced was used as an index of performance, there were cases of enterprises producing unnecessarily high-priced articles. Such micro irregularities left little option for the

planners but to change the success indicators on which material incentives were based on.

The main aim of the reforms of the incentive system and other processes of the economy in 1965 was to create more scope for initiative on the part of the managers so that it would contribute to increased management efficiency and make the managers willing to accept tauter plans. By the 1960s all the socialist economies in the Eastern Europe and the USSR had entered a new stage of economic development. The phase of extensive growth was over with the limited labour supply and increasing quality consciousness forced these economies to enter the stage of intensive growth, so the indicators of success became more quality oriented than quantitative. Secondly, the Soviet Union and other East European Socialist countries saw the strong dominance of "sellers' market", especially for consumer goods. This was understood to be largely due to the negligence of the enterprises to the consumers' demand. Leave alone the irresponsible behaviour of the enterprise managers, the system of incentive was itself not conducive enough to force the enterprises to cater for the tastes and demands of the consumers. So these needed a substantial change in the incentive mechanism in the socialist countries of Eastern Europe and the USSR.

Although different funds for developmental and cultural activities were created after the reforms of 1965 in the Soviet Union, the bonus fund remained as the main source of material incentives to the managers and workers.⁵ Before the reforms, the bonuses were included in the production costs and were paid from the wage fund. After the reform, the practice of paying bonus from the profit earned was introduced. The size of the bonus fund was dependent on the total sales (or profit) and profitability of the enterprise. Sales were defined as the value of output not only produced but also sold. But this criterion could not be applied uniformly for all the enterprises. So it had to incorporate the changes in the inventory and also the work in progress for certain enterprises. There were some confusion regarding the definition of profitability. In fact, two definitions of profitability were used. The first one was a gross concept and was defined as the ratio of the planned profit to the planned average annual stock of fixed and working capital. In the second definition the numerator was changed to make it a net concept. Here

5. Bonuses to the workers were paid from the material incentive fund, as well as from the wage fund.

profit was taken as net of capital charges, fixed payment to the budget and interest on bank loans. The norm set for bonus fund formation was as follows. For each planned percentage increase in sales (or profit) over the previous year, a certain percentage of the wage bill to be diverted to the bonus fund of the enterprise. The same procedure was followed in case of profitability also. By this procedure, although the sales (or profit) or profitability was supposed to be the main determinant of the size of the bonus fund, yet given the above formula, the size of the wage fund also played its role in determining the size of the bonus fund. For above plan fulfilment of targets, a new norm was set up which specifies that bonuses to be paid in the same way, but at a decreasing rate, with the condition that the total amount of bonuses paid for planned overfulfilment of targets not to exceed 30 per cent of the bonus fund for planned fulfilment. Certain other measures of disincentives were devised for non-fulfilment of plan targets.

It was initially supposed that the norms set up would be stable for a certain period of time (for few years at least) and were to be differentiated by branch or even by groups of enterprises within the same branch.

No limit to the deductions to the material incentive fund was proposed. The idea of the reforms in the bonus system was to make profit or profitability play a more important role in developing initiative and better sense of responsibility among the managers and workers of the enterprises.

Two other incentive funds were created after the reform of 1965 in the Soviet Union. One was called the production development fund which was to serve as a supplement to central investment of capital and was formed through deductions from profit and certain amortization earmarked for the complete renovation of the fixed capital. The other was the fund for the promotion of socio-cultural activities and construction of houses. This fund was also formed in a similar way.

Besides these, there were different other ways of providing material incentives to workers, managers, technocrats, rationalizers etc. The types of incentives mostly took the form of one time financial assistance. These used to be given for various reasons like innovation, some extraordinary work, utilization of waste material etc. There was no clear cut criterion for reward of such types of incentives.

The immediate result of the reform of the incentive

system, along with the other reforms of the economic mechanism was highly satisfactory. By the year 1967, there was a substantial increase in the amount of net income left at the disposal of the enterprises. It was viewed by the planners that the increased autonomy on the part of the enterprises in financial matters would increase their initiative and act as a kind of incentive. The size of the material incentive fund increased in a period of 21 months by 80 per cent, as compared to that in 1965, the fund for socio-cultural activities and house construction by 60 per cent and the production development fund by 210 per cent.⁶ The introduction of the new indicators forced the enterprises to cater to the consumers' demand. So stability became an important factor determining the production decisions of the enterprises. It can be argued that in a sellers' market, the introduction of 'sales' or 'profit' as indicators of success, need not lead to improvement in quality of goods. It is true to some extent. The mid sixties saw severe shortage of many goods in the Soviet Union. But by that time, general shortage of many of the consumer goods was

6. E.G. Liberman, "Economic Methods and Effectiveness of Production", Problems of Economics, Vol. XIV, Nos. 7-9, 1971, pp.19-20.

eradicated and the consumers became quality conscious. This situation coupled with the new system of incentives forced the enterprises to produce goods, which would, at least, get sold. On the one hand, the production of number of goods with no market demand, stopped and on the other, the production of goods of inferior quality decreased.

The new indicators solved some of the problems associated with the indicators used earlier. But gradually with the operation of this incentive system, the new indicators of success created a new set of problems, both at micro and at macro levels. It was originally expected that profit and profitability would play the most important role in determining the behaviour of the enterprises. But contrary to that, these indicators failed to occupy that place in planning and evaluating the work of the enterprises. The payments to incentive funds from profits varied widely from enterprise to enterprise. In number of cases the share of total profits going to the incentive funds was insignificant. For example, at the KOSINKII KNITWEAR FACTORY, payments for production development fund was only 3.6 per cent of the total profit, whereas, the payment going to the

budget amounted to 80 per cent of the profits (following the formation of the incentive funds).⁷ It so happened that over a period of time more of the enterprises started using 'sales' as the indicator of success. The dominance of this indicator led to the non-fulfilment of some of the ^{pects}exceptions, associated with the introduction of profit indicator. The fact that the size of profit was largely dependent on the cost of production with prices fixed, the enterprises using profit as an indicator of success would be more cost conscious. This would reduce waste and lead to more efficient management of the enterprises. But once 'sales' is used as an indicator, cost reduction becomes secondary in the priority of the enterprises. This is exactly what happened in the Soviet Union. Instead of devising cost reducing methods of production, the enterprises concentrated on production of goods on higher demands. This led to a further problem. The production structure as envisaged by the central planning authorities and was considered as socially necessary, could not emerge on account of the dominance of consumers' demand. Consumers' sovereignty, although, is desirable, but should not be aspired for at the cost of social interest.

7. Ibid., p.34.

especially in a socialist economy.

A serious planning problem arose with the new incentive system. This problem existed in the Soviet Union under the old method of planning and incentive payment, but this time, it took a slightly different form so far as the enterprises were concerned. A material reward for fulfilment (unplanned) and underfulfilment of plan targets posed a serious problem before the managers of the enterprises. The managers could choose either a low plan with the certainty of fulfilling it but taking the risk of overfulfilment, or they could select a higher plan targets with the risk of not being able to achieve those. The choice, although actually, depended largely on the objective conditions in each enterprise and the behaviour of the managers, yet, in most cases, the enterprise managers found a choice of a low plan preferable. We have already noted in the earlier chapter, that the finalisation of the plan targets was exclusively under the control of the central-authorities, and the enterprises only had some kind of a consultative voice in this respect, yet the bargaining strength of some enterprises used to be high enough to tilt the plan targets to their favour. Even if this did not work,

the enterprises could achieve this end by indirect methods. The managers could very often lower the figures of the amount of existing raw materials and the capacities of the machineries. This problem was not new to the Soviet Union. The introduction of the profit indicator was largely to eradicate this problem of hiding reserves by enterprises. There was no doubt of the fact that the new methods of incentives reduced the intensity of the problem substantially, but failed to eliminate it.

The misuse of the autonomy which the enterprises had in deciding on the norms to be fixed for distribution of bonuses, was also largely responsible for the malfunctioning of the new incentive system. The major share of the bonus fund was not paid monthly to the workers and others, as was expected earlier, but was paid as rewards for the fulfilment of some special assignments. So in number of enterprises the quality of normal work remained at a low level. There were other cases where the incorrect use of methods to achieve the targets for labour productivity led to the average wage outstripping labour productivity. For example, at the MINER MEAT COMBINE, during the years 1968 and 1969, 55 days off were declared working days in different shops and 14 days off

were declared working days throughout the combine. Not only that, 4548 overtime man hours were worked in that combine during the two years.⁸

The 'profit' and 'profitability' indicator could have functioned properly had these been associated with the necessary changes in the price system. But as the prices were more or less rigid even after the reforms, the expected results could not be achieved.

The failures of the 1965 reforms were apparent. The incentive system soon called for changes. In 1971, another package of reform measures were announced. The new method introduced was a step towards more centralisation. The incentive fund was to be assigned from the centre and was to be planned for a period of 5 years. For 1971-75, the planned annual rate of growth of the bonus fund was to be determined by the planned rate of growth of gross value of output (over the previous year). For each planned increase of a ruble of gross value of output, the bonus fund was enlarged by a certain fraction of the wage bill.⁹ The wage bill considered was not the current

8. Ibid., p.39.

9. Jan Adam, "The Present Soviet Incentive System", Soviet Studies, Vol. XXII, No. 3, July 1980, p.352.

wage bill, but the wage bill of the last year of the previous 5 year plan, i.e. 1970 for 1971-75. To stabilize the norms and for enterprises making temporary losses (either by producing new goods, by adopting new technology or by producing goods of low profitability), a central reserve bonus fund was created with 10 per cent of the bonus fund. The control of this bonus fund was entirely with the ministries and in some cases with the associations. Similarly as before, the enterprises were provided incentive for accepting higher plan targets than those envisaged in the plan for 1971-75. For every percentage point increase in the level of any or all of the three targets, accepted by the association on enterprise, the size of the bonus fund was to be increased by a certain percentage of the authorized actual wage bill of the enterprise in 1970.¹⁰ The norm established was stable and was separate for each target. The purpose of introduction of this norm was to cut down the role of wage bill as an indicator and thereby to retard the effect of growing wage bill on the incentive fund.

The methods of disincentives for overfulfilment and underfulfilment of the adopted plan targets were

10. Ibid., p.353.

continued even after 1971. The central authorities also fixed up the upper and lower limits to the size of the bonus fund. For the period 1971-75, the upper limit fixed, as percentage of total profit, was not to exceed the level achieved in 1970. The minimum was 40 per cent of the planned profit, provided the enterprises fulfill the necessary requirements regarding performance.¹¹

11. Ibid., p.355.

The formula that was used to determine the actual size of the bonus funds, in 1971, was as follows:

$$B_a = B_s + W \left[N_s (S_p - S_a) + P_s N_s (S_a - S_p) + N_r (R_p - R_a) + P_r N_r (R_a - R_p) + N_l (L_p - L_a) + P_l N_l (L_a - L_p) \right] + Q + P_1 + P_2$$

If any of the ^{inequalities} equations holds:

$$i) S_a < S_p \quad ii) R_a < R_p \quad iii) L_a < L_p$$

then for that indicator, only the rate of underfulfilment compared to the pledged rate is considered, where

P_1 = part of the profit produced above the plan.

P_2 = Profit resulting from price increases.

Q = Reward for improved quality.

B_a = The actual size of the bonus fund for a certain year in the period 1971-75.

B_s = Sum set by the five year plan for the bonus fund for that particular year.

W = Actual wage bill of 1971.

S_a, S_p, S_s are the actually achieved, pledged (by the enterprises) and set (from above) rates of increase in sales (S).

contd...p.116..

An important development in the incentive system in the USSR, after the reforms of 1971, was their increased attention to the qualitative aspects of performance. The size of the bonus fund was made dependent on the share of output of higher quality goods that the enterprises produced. Reduction of bonus for producing inferior goods was also introduced. But the method of incentives applied to encourage the production of higher quality goods could not be as successful as was expected. The main reason for that was that the actual amount of bonus which the workers received for improvement of quality was insignificant. For example, in the clothing industry, 15 per cent of the additional revenue earned by the enterprise resulting from the price increases on the production of higher quality goods was supposed to be diverted to the bonus fund for the workers. But in

contd...

R_a, R_p, R_s are the actually achieved, pledged and set rates of increase in profitability (R).

L_a, L_p, L_s are the actual, pledged and set rates of increase in productivity. (The rates of increase in all the above three cases are considered cumulative since 1970.)

N_a, N_p, N_1 are norms for a 1 per cent increase in the indicator compared with the pledged rate.

F_a, F_p, F_1 are norms for overfulfilment and under-fulfilment of targets.

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practice 4-6 per cent of it was paid as bonuses to the workers. In Mayek Association, the monthly average bonuses paid for improvement of quality were 5.3 rubles for workers, 7.4 rubles for managers and 11.4 rubles for engineers - which constituted a very small fraction of their basic pay.¹²

The incentive system underwent another series of changes during the period 1977-80. But the changes were not fundamental in nature. The gradual tendency for greater centralization was more noticeable in this period. The number of indicators increased again. The ministries were given more authority over the assignment of indicators. They were allowed to set 3 or at the most 4 indicators for enterprises. The targets for labour productivity and the production of 'higher quality goods'¹³ came to be set by the ministries. The other indicators

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(If the target is fulfilled $F=1$; if the target is overfulfilled, $F < 0.7 \times$ the corresponding norm; for underfulfilled targets $F > 1.3 \times$ the corresponding norm.)

12. Alice C. Gorlin, "Observations on Soviet Administrative Solutions: The Quality Problem in Soft Goods", Soviet Studies, Vol. XXIII, No. 2, April 1981, p. 172.
13. The higher quality goods were defined as those whose technico-economic parameters correspond to the West-ern standards and are competitive in foreign markets.

which were in existence were:¹⁴

1. Gross output (in physical or value term).
2. The level of general or calculated profitability.
3. Reduction in the cost of production.
4. Development of new technology and products.

Since there was not any uniform criterion for determining plan targets for enterprises, the jurisdiction of the ministries over the enterprises increased substantially.

1971 reforms had introduced a new indicator called the output of key industries. In 1977 this indicator was dropped and instead, the enterprises were brought under the obligation to meet contracts signed with buyers, in regards to assortment and time of delivery. The top managers were made to face bonus cuts in case of failure to honour any contract. The idea of such a policy was to streamline the distribution system.¹⁵

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14. Usually the indicators (3) and (4) were determined by the enterprises themselves and (1) and (2) by the central planning authority. The lack of uniform criterion led the central planners to set different indicators for different enterprises. They had right to choose any indicator for any enterprise.
 15. During 1976-80, the value of the unfulfilled contracts was computed as the percentage of the planned output and for each percentage point the bonus was shrunk by 1 per cent.

The role of 'profit' and the 'profitability' indicators has been further lowered after 1977. The debates in the early sixties had immense influence on the 1965 reforms to make these two indicators closely connected to the size of the bonus fund. The role and performance the profit or the profitability indicator played in practice was also something which could not be determined exactly. In a survey conducted in the Soviet Union in the late seventies has revealed that out of 183 executives of light industries and 137 directors of large departmental stores, 13.5 per cent of the executives and 21 per cent of the directors felt that 'profit' (sales) as an indicator of success helped to improve quality of consumer goods. 43.6 per cent reported that the profit index has led to the production of 'high quality and fashionable goods'. According to 41 per cent of those interviewed the distribution of profit does not encourage attention to quality and fashion. 30.3 per cent of them feared financial loss from the introduction of new products.¹⁶ The various doubts about the effectiveness of 'profit' as an indicator of success led to the delegation of its role from one of the important corrective indicators to one of the number of other

16. Alice Gorlin, n.12, p.170.

indicators which the ministry could impose in addition to two other compulsory indicators (productivity and quality).

SECTION IITHE HUNGARIAN CASE

The Hungarian incentive system, prior to the reforms of 1968, was no different from the Soviet pre reform model (to large extent similar to the post reform model also). Incentives to workers and managers were provided for quantitative fulfilment or overfulfilment of plan targets. Various indicators of performance were used, all of the type used in the Soviet Union and other East European Socialist countries - gross output, gross value of output, value of output realised etc. The use of such indicators of success to determine the size of bonuses to the workers and managers gave rise to the same kind of macro and micro-economic problems as were experienced in the Soviet Union and the other socialist countries. The widespread prevalence of waste and inefficiency prompted many economists in Hungary to reconsider the whole question of incentives. Profit was widely used in all the East European Socialist countries during the period 1945-47 as an indicator of success. At that time it was legitimised on the ground that the economies were in the transition from capitalism to socialism. But soon reaction against the use of profit as a success

indicator and a principle determining production and investment decisions soon followed and as a result it was abandoned to a large extent in all these countries.¹⁷ The wave to use profit as a performance indicator hit Hungary strongly during the fifties. In 1957, according to the new scheme introduced, profit sharing was made dependent on the improvement of the profit rate (profit rate compared with that in the previous year).¹⁸ But this alone did not change the basic mechanism of the incentive system.

The major objectives of the reforms of the incentive system in Hungary in 1968 were:

- i) to connect material incentives and the interest of the enterprises directly to the actual profit.
- ii) to make the development of the enterprises and the personal income of the employees of the enterprises depend on profit.
- iii) to provide incentives to reveal the hidden resources, efficient utilisation of labour and other resources.

17. J. Mieczynski, Profit, Risk and Incentives under Socialist Economic Planning (London: Macmillan, 1973), p.16.

18. Istvan Buda, "Wage Regulation and Manpower Management" in Otto Gado (Ed.), Reform of the Economic Mechanism in Hungary (Budapest: Akademiai Kiado, 1972), p.91.

- iv) to generate sufficient initiative among the managers and workers so that decision making can be effectively decentralised.

After the 1968 reforms, a part of the enterprises' total profit was to be kept as reserves, and the rest was to be divided between the development fund and the fund for increasing personal incomes.¹⁹ The size of each of these two funds was dependent on the relative importance of wages and gross value of assets in the particular enterprises, given certain adjustment made in the amount

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19. Bela Balassa, "The Firm in the New Economic Mechanism in Hungary" in Morris Bornstein (Ed.), Plan and Market (London: Yale University Press, 1973), p.350. After the formation of the reserve fund, the formula used for the division of total profit into the development fund and the distribution fund (the fund for increasing personal incomes of the employees has been named in various ways in the English translations, e.g. sharing fund, bonus fund, distribution fund etc.) is as follows:

$$N_{dis} = P \cdot \frac{sB}{sB + E} \quad \text{and} \quad N_{dev} = P \cdot \frac{E}{sB + E}$$

where P = Total profit

N_{dis} = The size of the pre-tax distribution fund.

N_{dev} = The size of the pre-tax development fund.

B = Total wage bill.

E = Total volume of assets.

s = Wage multiplier

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of wages on a industry by industry basis. Both the funds were subject to taxation. The development fund was to be taxed on a linear scale, which was 60 per cent in general.²⁰ The distribution fund was subject to progressive taxation dependent upon the wage norm set. The marginal tax rate varied between 0 and 70 per cent. This system of taxation was changed in 1971 allowing for the progressive taxation to move within a narrower range.²¹

State subsidies played a significant role in increasing the material interests of the enterprise managers and the workers. Subsidies were of various forms and were

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The total wage bill was determined in 1968 by multiplying the total wage norm set for the enterprise by the number of workers. Later on, it was changed to the actual wage bill paid out by the respective enterprises. Also, upto 1970, the value of the wage multiplier was 2. Beginning from 1971, the pay-roll expenditure was to be multiplied generally by 3.

The fund could be augmented from other sources also. For example, the amount of the subsidy approved by the supervising organisation or the enterprise, bonus like earnings of the enterprises, incomes accruing from the repayments of the loans given to the employees to finance housing, incomes of the institutions mainly from the sharing fund etc.

20. Ibid., p.350.

21. Sándor Ferge and László Antal, "Enterprise Income Regulations" in Otto Gado (Ed.), Reform of the Economic Mechanism in Hungary, Development 1968-71 (Budapest: Akadémiai Kiadó, 1972), p.65.

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also supplemented by exemptions from paying charges on assets and from wage tax.

The development fund was used to augment the fixed and working capital of the enterprises. The distribution on the sharing fund was meant for increasing of personal incomes of the employees and for cultural, social and

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The following table will indicate the tax rates in the 1970 and the 1971 systems:

1970		1971	
Band of sharing in percentage of wages paid	Tax rate per cent	Bands of sharing fund in percentage of wages paid	Tax rate per cent
0 - 7	0	0 - 6	40
7 - 9	20	6 - 12	50
9 - 11	30	12 - 20	60
11 - 13	40	20 -	70
13 - 15	50		
15 - 17	60		
17 -	70		

Source: Sandor Ferge and Leslie Antal, n.21, pp.65-66.

educational expenditures.²² The first part took into account bonus payment and increases in average wages above the wage norm set by the central planners. The reserve fund was to take care of sudden fluctuations in the level of profit of the enterprises. The scope of utilizing the general reserve fund was extended subsequently so as to make possible to compensate losses resulting from sudden price fluctuations, especially in connection with trade with foreign countries.²³

22. The central Statutes used to draw the limits of the utilisation of the Sharing fund - the limits in the sense that it used to specify the areas in which the fund should be utilised. The main purposes for which the sharing fund was used were as follows:

(A) to pay bonuses for the performance of predetermined targets except those charged on the wage cost, (B) innovation fees including those paid to persons, not an employee of the enterprises, (C) rewards for outstanding technical performance except those charged on the wage costs, (D) other rewards not charged on the wage costs, (E) annual profits share, (F) the employees' contribution to housing projects paid or advanced on behalf of the employees, (G) the scholarships and aids, (H) contribution to reduced rate catering for employees in work canteens, (J) contribution to nurseries, kindergartens, (K) contribution to enterprise financed housing projects, (L) social, cultural and sports activities.

- Source: Ministry of Labour Decree 13 of 1967, Sec.2 Budapest, Hungary.

23. László Racs and Imre Vincze, "World Market Prices and Domestic Prices" in Otto Gado (Ed.), n.21, p.131.

The incentive system along with various wage regulations introduced in 1968 made a departure from the usual practice of linking material incentives to the quantitative fulfilment or overfulfilment of plan targets. This itself was an important step towards increasing enterprise autonomy. While it was largely effective in developing initiative and sense of responsibility among the workers and the managers, the methods used for payment of bonuses and other devices introduced to regulate wages, gave rise to certain serious macro and micro irregularities. Immediately after the new system of economic management came into being, substantial discussions took place relating to the behaviour of the employees of the enterprises in the given framework of planning. It was originally believed that the enterprises would try to maximise both the pre tax distribution fund and the pre tax development fund, and the fact that since the sizes of both these two funds were dependent on profit of the enterprise, the enterprise would actually aim at maximisation of profit. But in practice what happened was totally different. The enterprises were more interested in maximising the distribution fund, and that they could do simply by increasing

the wage bill,²⁴ since wage norm was centrally determined,

24. Let us take the simplified distribution formulae -
(ref. n.19)

$$N_{dis} = P \cdot \frac{SB}{SB+E} \quad \dots\dots\dots (1)$$

$$N_{dev} = P \cdot \frac{E}{SB+E} \quad \dots\dots\dots (2)$$

$$** N_{dis} + N_{dev} = P \quad \dots\dots\dots (3)$$

$$\text{Max. } (N_{dis} + N_{dev}) \Rightarrow \text{max. } P.$$

$$\text{Also } N_{dis} \propto P$$

$$\text{and } N_{dev} \propto P$$

So both N_{dis} and N_{dev} can be increased by increasing P .

Logically, one would expect that the enterprises would attempt to maximise P to maximise N_{dis} and N_{dev} . But what is overlooked here is the distribution of P between N_{dev} and N_{dis} and their relationship with B and E , s being a policy determined constant.

From (1), (2) and (3) we have,

$$N_{dis} \propto B$$

$$N_{dev} \propto \frac{1}{B}$$

$$N_{dis} \propto \frac{1}{E}$$

$$\text{and } N_{dev} \propto E$$

Since B (total wage bill) and E (total value of assets) enter into the calculation of P , and their relations being

$P \propto \frac{1}{B}$ and $P \propto \frac{1}{E}$, the actual choice situation becomes complicated.

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the same was achieved by increasing the number of workers.
Another tendency which was noticed in Hungary after 1968

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Case I. N_{dis} and N_{dev} (thereby $N_{dis} + N_{dev}$) can be increased independently by increasing the level of P . So if the enterprise is interested in maximising both N_{dev} and N_{dis} , then the most rational thing for them to do would be to maximise P , accepting an optional combination of B and E .

Optimum

Case II. Suppose the enterprise is interested in maximising only N_{dis} .

There can be two choices:

a) They maximise P by minimising B . (assume E as constant. It can be a fairly rational assumption, since the capital stock cannot be increased substantially over a short production period).

In that case they would use the least number of workers (wage rate being centrally determined).

b) They maximise B by minimising P . (again keeping E as constant).

In this case they will employ large number of workers.

The choice between (a) and (b) need not be one dependent upon the expected level of income. It also takes into account the risk factor.

In a labour shortage economy, the enterprise would always like to keep some workers in reserve so as to meet sudden requirements for increased level of output. Another factor may influence the choice. They may now keep the level of profit at a certain level by keeping E at minimum and increasing B accordingly. This will lead to maximisation of N_{dis} at the cost of N_{dev} given the level of profit.

So far the enterprises, interested more in maximising N_{dis} alone, would take up the choice (b).

The enterprises also can avert the risk of facing

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was that since only the distribution fund was taxable and not the allowed amount of wages, the maximisation of after tax profits, minus wage payments and that of pre tax profits did not coincide. After tax profits net of wages could be enlarged by increased utilisation of low-wage labour. This would lead, on one hand, to increase in cost (and thereby reducing pre tax profits) and on the other to reduce average wages (so that the after tax profits net of wage payments could be maximised).²⁵ For many of the enterprises, the main concern was to maximise the after tax profits. so the keeping of low wage and unqualified workers became a regular practice.²⁶ The same tendency was possibly strengthened by the practice of not allowing the enterprises to set wage rate 4 per cent above the norm determined by the centre. The effects of such practices were against the basic objectives of economic planning at that time, that is of increasing labour productivity.²⁷ Not only that, the hoarding of surplus labour by some enterprises created an artificial

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shortage of labour and also maintain a higher level of profit (P) by employing low wage labour thereby not allowing the total wage bill increase. In practice both these two theoretical possibilities were observed.

25. Bela Balassa, n.19, p.351.

26. Istvan Buda, n.18, p.92.

27. Labour productivity (output per worker) in 1968 rose only by 1.5 per cent as compared to the average of 5 per cent in the previous years. Bela Balassa, n.19, p.352.

shortage of labour for other enterprises. A study conducted by the Research Institute for Industrial Economics of the Academy of Science has revealed that in 57 per cent of the enterprises faced labour shortage while 43 per cent of the enterprises were using surplus labour.²⁸

After two years of the introduction of the reforms, certain changes were made in the incentive system. The wage norm was abolished and for computing the size of the distribution fund, the actual wage bill was taken into use. (See note 4.) The 4 per cent ceiling on wage increases was also abolished. A new scale of taxation was applied for taxing the distribution fund. (See note 5.) In 1970 the increase in wage bill resulting from extra employment became taxable. The new rules prescribed that 75 per cent of the increases in wage rate upto 4 per cent compared with the level in 1970, could be accounted for as the increase in cost; but, in the case of the other 25 per cent and any increase in wage rate above 4 per cent the amount to be deducted from the distribution fund.²⁹ These rules were introduced especially to remove

28. Ibid., p.35.

29. Certain other minor changes were introduced regarding wage regulations for the period 1971-1975. But these changes were not fundamental in nature.

the distortion created by the malpractices of the enterprises to maximise their immediate material interests.

The 1956 bonus system created conditions leading to income inequality between the managers and the workers. It was decided that the workers will not get bonus 15 per cent above their wage, whereas the limit set for the size of bonus for the managers was at 80 per cent of their basic salary. This principle could not be accepted at least on socialist principles and ethics. In 1970 the rules had to be changed to a set limit of 25 per cent for all categories of employees. At the same time, the basic salaries of the managers were increased. Initially the workers also had to face pay cuts in case of under-fulfilment of plan targets and assignments. In some later period the workers were exempted from payments in such cases. The managers still had to bear the total responsibility of fulfilling plan targets and assignments, under the threat of pay cuts. The linking of incentives to the level of profit made by the enterprise, was bound to bring in inequality in income. It resulted either from the structure of prices and frequent price changes or from the general technical and production conditions of the industries. It was after reported that the price

structure was not beneficial to number of enterprises. Certain goods were priced abnormally high so that the demand for that good is forcibly kept low. At the same time there were goods which were lowly priced.³⁰ This affected the profit level of the enterprises. Some of the enterprises benefitted from such price policies and extracted more profit than what they would have done under normal conditions, and some others were faced exactly with the opposite situation. The techno-economic conditions of productions are such that certain goods can be produced more profitably than others. This brings in inequality in profits to a large extent. Whatever steps were taken to reduce the income gap between various industries, the effect was nominal. So the Government often had to interfere in the running of the enterprises. Subsidies, tax concessions were provided to the enterprises making losses. But such measures were to be adopted only when the reasons for losses are totally unconnected with the efforts of the enterprises, and mostly unforeseen. But in practice, it became a habit of the management of enterprises to seek help. Various reasons for failure

30. Thereby lowering the total revenue and profit of the enterprise.

can be enumerated, "Lobbying begins... Personal connections are used to get more concession".³¹ Bankruptcy is thereby avoided. The policy of tax concession and subsidy led to high level of income differentiation between the export industries and the other industries, catering for domestic market.

It is thus observed in Hungary, that the pre reform period saw many of the distortions created by the existing incentive system were mainly of micro nature. This is not to say that such distortions did not have any macro implications. But since these were created mainly at the enterprise level, by the managers and workers, at the level of current production decisions of the enterprises, the corrective measures could be taken at the enterprise level itself. But after the abolition of the plan target-bonus link and introduction of profit as the only criteria determining the size of material incentives, the problems took a different dimension. The problems of income inequality, shortage of labour, business fluctuations etc. were more specific to the national economy as a whole.

31. Janos Kornai, "The Dilemmas of a Socialist Economy, The Hungarian Experience", Cambridge Journal of Economics, No.2, June 1980.

Such distortions could not always be corrected by improved functioning of the enterprises. So certain secondary or minor changes in the incentive system could not ensure the eradication of such irregularities.

CHAPTER IV

CONCLUSION

The enterprise being a historical category, its content is determined by the material conditions of the society - the level of productive forces and the relations of production. Considering State Ownership of means of production as different from social ownership, the enterprises under State ownership will play a different role than under social ownership. If we consider workers' effective control over the means and conditions of production as a necessary condition for the socialisation of means of production, then it will not be difficult for us to argue that social ownership of means of production has not been achieved either in the Soviet Union or in Hungary. Given the State Ownership of means of production the enterprises both in the Soviet Union or in Hungary, in spite of the various reforms, failed to breakaway from the old framework and to provide a social character to the production process. So the social content of the enterprises over the years in both these two countries has not changed to any remarkable degree.

Even when the social character of the enterprise has

not changed the various reform measures have brought in certain institutional changes which have altered the legal status of the enterprises. The changes in the legal framework have largely determined the position of the enterprises in the management and planning hierarchy. The legal provisions had very often to be changed in accordance with the changes in planning methods and management techniques. So at different points of time as required by the central plan, the enterprises were assigned various roles to play and were subjected to different levels of autonomy.

Till 1965, in spite of various reforms, the position of the enterprises in the economy remained unchanged. Prior to 1957 all the attempts to decentralise the economy resulted in an increase in the autonomy of the branch ministries. After the Sovnarkhozhy experiment in 1957, the responsibility and the power of decision making was largely transferred from the Ministries and Gosplan to the new regional management organisations created. So till the 1965 reforms, at no point of time was decentralisation seen from the point of view of the enterprise. The general direction of the reforms indicates that the central planners had never taken the question of enterprise autonomy seriously. What the planners really tried was to shift some of the

responsibilities to the lower bodies (in relation to the ministries and the central planning bodies). This resulted in relative concentration of responsibilities and power at the middle levels of the administrative and management hierarchy. Prior to 1957, it was the branch ministries which became more important and after 1957 it was the Sovnarkhoz. Throughout this period, except for some minor changes, enterprises continued to have the same kind of relations with the other organisations in planning and management leaving their position in the economy unaltered.

It is sometimes argued that though the creation of Sovnarkhozy failed to give more autonomy to the enterprises, yet the experiment succeeded in bringing the enterprises closer to decision makers and to have direct contact with them. Even while not legally empowered, the enterprises could influence the decisions taken by the directors and planners of the Sovnarkhozy. Thus the enterprises enjoyed some kind of 'de facto freedom'. The bargaining strength of the enterprises increased, but this was not enough to bring about a fundamental change in their role and position in the economy. The reason for such changes in the administration of the enterprises was the obvious realisation of the

inadequacy of a 'command' type planning and management structure. But the conservative character of the Soviet planners on the one hand and the political necessity on the other, left the question of enterprise autonomy untouched.

After the reform debate, a drastic change in the economic mechanism was expected. In the reform debate, various problems related to the malfunctioning of the centralised planning and management system, and the question of the autonomy of the enterprises were discussed widely. The actual model adopted after the reforms in the Soviet Union enlarged the scope of the enterprises' decision-making on distributional and other matters. But so far the production and investment decisions were concerned, the position did not improve to any large extent. Even on those areas where the enterprise was supposed to have gained some autonomy, the actual legal framework was defined in such a way that the scope of intervention of the higher authorities on the day to day functioning of the enterprises was never ruled out. So far as the enterprises are concerned, the 1965 reforms were a step towards enterprise autonomy unlike the earlier reforms. But the fact that the central plan continued

to exist as the guiding force in the economy, the role of the enterprises did not expand to the extent of influencing the economic processes or the general direction of the economy. So the hue and cry about decentralisation in the Soviet economy following the reforms in 1965 was fundamentally meaningless. Neither was 'Liberianism' ever practised nor was any serious attempt made in the direction of allowing the enterprises to decide the course of the economy. The 1965 reforms basically were to correct some of the distortions in the planning procedures with certain short term modifications in the planning and management methods. The short term nature of the reforms can very well be proved by the fact that the weak kind of decentralisation move, which was initiated with the reforms in 1965, soon came to end giving rise to a process of recentralisation in the seventies and early eighties. What is noticeable in the post 1965 developments is the fact that with the creation of production associations, the responsibilities and the power of economic decision making was again shifted to the middle level organisations like the associations. With the abolition of the Sovnarkhozy, the branch ministries had come to play more important a role in the management and planning process. The 1965

reforms effectively demolished the role of such intermediate organisations and the responsibilities were divided between the ministries on the one hand and the enterprises on the other - with the ministries gaining the major share. The formation of production associations brought about another series of transfer of responsibilities and power, this time from the ministries to the associations, i.e. to the middle level organisations. Thus it is observed that the role of the enterprises in the economy did not undergo any drastic change during the whole reform period.

The increased enterprise autonomy in the Soviet economy, which is more talked about after the reforms in 1965, is somewhat related to the modifications made in the incentive system. It emerged from the decrease in the number of compulsory indicators set for the enterprises. On the one hand, it depicted the inability of the planners to provide all the necessary plan instructions in totally disaggregated form and on the other, it sought to correct the distortions created in the incentive system. The autonomy provided to the enterprises at various levels was just what the enterprises required for the smooth functioning of the newly introduced incentive system. The introduction of profit as an

indicator of success needed complete cost accounting and the freedom to take all the necessary steps to lower costs and adopt new techniques of production. After the 1965 incentive system was gradually abandoned, the number of indicators set for the enterprises soon started rising and the autonomy of the enterprises in their decision-making started falling.

So the enterprises in the Soviet Union continue with little or no effective autonomy in planning and management of the economy. The fundamental character of the incentive system also has not changed. Bonuses continue to be based on quantitative fulfilment of plan targets. But the plan indicators have often been changed. There are two major reasons for the changes in the plan indicators. Firstly it was the inadequacy of each indicator to get plan implemented in the desired way. Every indicator of success is associated with a unique set of problems. In the process of application of any one of these, problems are always expected to crop up. Whether these are gross physical output indicators or profit, their applicability is always limited. The production of extra heavy goods or the non production of goods in lower demand are some of the

distortions created by the various success indicators in the socialist economies. It is not that the indicators could never be used to arrive at fruitful results - the successful use of the indicators depended largely upon the commitment of the workers and the managers to the central plan and their interest in seriously implementing the objectives of the plan. But when such conditions are not satisfied, changes in indicators are demanded depending upon the nature and intensity of the distortions created by the use of that particular indicator. Secondly the necessity for new indicators was arising out of the broader economic policies of the planners. The macro economic priorities of the planners changed with the development of the economy itself. At the stage of extensive growth the fulfilment of the minimum requirements of the people and thereby the maximisation of the gross volume of output was the prime concern for the planners. So the indicators of success were more quantitative and defined in terms of physical volume of output. But once the stage of extensive growth of the economy was over and the new phase of economic development, with the adoption of intensive growth strategy, was ushered in, the priorities of the planners changed to ones of increased labour productivity,

minimisation of waste, satisfaction of consumer demand and the improvement in the quality of output. The industrialisation strategy adopted in the Soviet Union resembling the Feldman model, emphasised on developing the capital goods sector and on paying more attention to accumulation rather than to consumption at the initial stages of development. So the phase of extensive growth was characterised by the creation of high capacity in the 'capacity creating sector' and thereby lowering the level of output of consumer goods. So in the new stage of economic development where intensive growth is the major concern, not only had the indicators of success to be quality and efficiency oriented, but also had to cater to the increased demand for high quality consumer goods. The introduction of 'profit' (or sales) and 'profitability' as indicators of performance after the reforms of 1965 basically had two objectives. On the one hand it was expected to increase efficiency and minimise costs thereby bringing wastes to the minimum, and on the other, it was thought that the indicators would force the enterprises to be quality conscious since the total volume of sales entered as a determinant of the size of the bonus fund. But the introduction of these indicators, per se, was not enough to increase

the production of consumer goods. When it was felt that the "sellers' market" continued to exist in the Soviet Union, even after the reforms in 1965, special attention had to be paid to the increased production of consumer goods. By the seventies, the shortage of many consumer goods was done away with, but the problem associated with the production of inferior goods was not overcome. As a result, one could see the glut of one good in the market at a time when there was absolute shortage of the same good of a different quality. So the seventies saw the introduction of various success indicators which were expected to serve the immediate requirements of the economy. Those types of indicators did not have any long term policy orientation, neither did they have any ideological and political direction. The variations were specific in nature and no serious economic, political or ideological trend emerged. The only trend which can be observed at a very general level is the growing attention of Soviet planners to the adoption of economic methods and their increased reliance on them. Political and ideological substantiation is provided to the various economic measures adopted. But this has been of little relevance to the content and the nature of the economic policies. 'Decentralisation'

and 'Centralisation' are both justified as the specific ideological and political demands of 'advanced socialism'. But what is difficult to understand is the ideological rationalisation provided to the process of decentralisation in the sixties - a period preceded and followed by concentration and centralisation of production and management. If the various reforms had serious ideological considerations, then the question arises why the road to 'advanced socialism' characterised by concentration of production and highly centralized planning system could not be built without undergoing the reforms in the sixties. With the same logic one can come to say that the various reform measures undertaken during the seventies and the eighties were mere attempts to arrive at certain technical solutions to the problems in the economy.

What has been attempted to argue so far is that there is no clear cut trend in the development of the incentive system and the autonomy of the enterprises. The different reforms had little political and ideological consideration and were merely economic methods to do away with certain distortions created by the shortcomings of the planning and management system itself.

The Hungarian story is similar, but not identical. Although there was not any experiment of the nature of the one of 1957 in the Soviet Union (the Sovnarkhozny experiment), the pre-reform economy in Hungary had experienced a similar tendency of increasing autonomy of certain middle level organisations like the trusts and the associations, and thereby going for a decentralisation from the point of view of the central planners and other similar bodies. No serious attempt was made to increase the autonomy of the enterprises. It is interesting to note that prior to 1968, the Hungarian planners, for whatever reasons, had never ventured into any serious experimentation with the economic mechanism. They used to follow the Soviet pattern of management and were more conservative to changes. But the 1968 reforms made a powerful breakthrough. The need for such a radical departure from the commonly accepted models of socialist planning had emerged from the economy itself. The political and ideological opposition to the reforms were covered by economic reasoning. The Hungarian economy also by that time completed the stage of extensive growth and had entered the phase of intensive one. The new economic needs arising, could not be met by the methods within the old framework of central

planning. The other aspect in the case of the Hungarian economy, which was absent in the Soviet economy, was Hungary's overdependence on foreign trade. The foreign trade sector had such a large share in Hungary's national income that its survival and growth was crucial to the economy. So the problem of quality or technology in general, to make goods competitive in the foreign markets, both quality and price wise, had more importance to the planners. In fact, Hungary had to pay more attention to the competitiveness of their goods in the Western European markets and to the development of their export sector than the USSR. The low level of development of indigenous technology, especially in the consumer goods sector, had forced Hungary to depend on the import of technology from the Western capitalist countries. Not only that, a large proportion of the domestic investments was made possible by the import of capital from the various capitalist countries. The recession in the West and Hungary's increasing indebtedness have made the export sector in Hungary a priority sector. It was felt by the Hungarian planners that the expansion of trade is very often hampered by the inadequate freedom provided to the enterprises or by the inflexible price system which failed to correspond to the prices in

the international market. So the demand for the extra autonomy to the enterprises was raised much more strongly in Hungary. The reform discussions in Hungary, in fact, attempted to sophisticate the planning and management methods, both in theory and practice, with a clear view of Hungary's position in foreign trade. The radical reforms which were subsequently followed in 1968 bore the stamp of the various theoreticians' concern about the problem of enterprise autonomy. The 'radicalism' of 1968 reforms did not let the model break away from the central planning system. What it made possible was a departure from the 'directive' model of planning. This itself was probably the most important step ever taken in the history of economic reforms in the centrally planned socialist economies. But when the question of autonomy is raised within the framework of central planning it is taken in a limited sense. Complete freedom of the enterprises in decision making is clearly incompatible with central planning. So in Hungary, although the enterprises were given relatively high degree of autonomy, their scope of operation was limited by various legal provisions which made the interventions of the central authorities in the activities of the enterprises, permissible. In the initial post-reform

period, the intervention of the ministries and other higher planning bodies was minimum - thereby allowing the enterprises to do whatever they felt best for themselves, as well as for the economy as a whole. But the Hungarian experiment did not achieve the success expected. The cause of this is very often ascribed to the failure of the enterprises. This invited Government intervention into the affairs of the enterprises - thereby reducing their effective autonomy. The process of 'recentralisation' which is very often talked about is not of the kind which took place in the Soviet Union. Whereas the recentralisation in the Soviet Union took place with the formation of production associations and other intermediate organisations, the Hungarian experience was that of a mere increase in the intervention of the ministries in the enterprise-level decision-making and a conscious subordination of the enterprise level decisions to the national economic policies framed by the central planners. It is interesting to note that in Hungary no general trend of further increase or decrease of enterprise autonomy can be traced. On the one hand one sees certain developments leading to centralisation, and on the other, one observes

steps taken to free the economy from bureaucratic ties. The question of enterprise autonomy in Hungary has, in fact, been used to mean eradication of bureaucracy and of unnecessary central interventions rather than a process of delegation of decision making to the enterprises. The legal position of the enterprises in the economy has not also undergone any radical change since the reforms in 1968. The increase or decrease of autonomy has never been guided by a conscious policy - but by a short term assessment of the enterprise performances in terms of the levels to which the enterprises fulfil the basic national objectives of planning.

The delinking of the bonuses paid to the workers and other employees from the quantitative fulfilment of the plan targets was an important step in the reforms of the central planning system in Hungary. But as has been discussed earlier, the new model adopted in Hungary, although free from many of the defects of the Soviet model, was not totally free from various other micro-distortions. The macro-problems also took alarming proportion in the form of creating income inequalities among various enterprises and also among different categories of employees and workers. The imperfection in the incentive system often called for Government

interventions in the form of providing subsidies to enterprises making losses and taxing away of the extra profit earned by some of the successful ones. Such interventions actually had destroyed the kind of environment where the autonomy of the enterprises could flourish and yield the desired results. The incentive system geared toward maximisation of profit and thereby towards minimisation of costs and improvement of efficiency, incorporates the acceptance of profit differentials and subsequently of income inequality. Also it does take into account the existence and acceptance of competition among the socialist enterprises. So given some level of competition which was encouraged in all the socialist countries, some degree of autonomy of the enterprises and an incentive system where profit is the bonus forming indicator, it will be surprising not to expect income inequality cropping up (even theoretically). If other measures are taken up simultaneously to do away with the ill effects of the profit indicator, then the whole idea behind the adoption of such an economic policy is lost. The difficulty here is that income inequality (that too at the level it exists in the socialist countries) is not a major economic issue - but its political and ideological significance

is enormous. Socialist ethics thus comes in contradiction with the economic policies.

The Hungarian experiment was a novel one - ending with success in various fields. But the new system at the same time posed its own contradictions, effects of which could not be accepted politically. The fact that the economic and political exigencies of the time limited the scope of the reforms substantially, yet unlike, as many argue (e.g. Brus), the incomplete character of Hungarian reforms was not the main cause of its failure. The reforms were not in fact attempts at decentralization of the economic decision making per se, but to strengthen the central planning by bringing in more flexibility in planning and by making the best of the talents in various economic agents. But the fact that even as a mere economic method to strengthen central planning and thereby to advance socialism, the increased autonomy of the enterprises and the other changes brought in after 1968, failed to serve their purpose and as a consequence invited frequent central interventions into the affairs of the enterprises. The model like any others adopted in various socialist economies at different points of time, could not be perfect, even theoretically. The fact that any economic policy, is faced with a number

of objectives, and the number is very high, then it successfully fulfils some while failing to achieve the rest. So the overall performance of the particular policy cannot be assessed in terms of the mere number of objectives fulfilled - but by the kind of objectives. So the priority set by the planners is crucial. The New Economic Mechanism solved many of the economic problems, but at the same time created political and ideological problems related to the construction of socialism. So the 1968 Hungarian reform model could not be retained in its form and content for a longer period of time.

At a more technical level the problem can be traced in the existence of a contradiction between the planners' priorities and consumers' preference in the Soviet Union, as well as in Hungary. The problem is largely informational and is related to the basic structure of central planning. At a theoretical level, it can be possible to argue that the central planners can design the structure of output exactly satisfying consumers' demand. But in practice this has never been possible in any of the socialist countries. Supply of goods does not match consumers' demand. Attempts are made to do away with such discrepancies. Incentives are provided to the

enterprise managers and workers, extra independence is given to the enterprises to take decisions or central interventions are made more frequent. A very high level of attention is being paid to the improvement of the information system both in the USSR and Hungary. Cybernetics has been developed. But the problem is being much more complicated by the rapidly changing tastes and the needs of the people. The Hungarian planners have taken steps to develop and use market forces to determine the level and the structure of output. The market is used in the Soviet Union also, but its scope of operation is more limited and the planners there have concentrated on the improvement of central planning by developing the information structure and the formation of production associations. These measures have brought in a higher level of centralisation. The increased centralisation has in turn called for more use of the incentive mechanism. This is the reason why one sees the Soviet planners preoccupied with the problem of success indicators.

While we have seen that the central planning system, both in the USSR and Hungary are not free from defects, the methods applied in both these countries to rectify the system have also been economic - rather than

political or ideological. The dominance of politics over economics, which should characterise an ideal socialist economy, has not been achieved in any of these socialist countries under study.

The theoretical justification provided to the use of material incentives by referring to the principles 'to each according to his work' is misleading. Lenin enunciated this principle in a different context. He referred to the income inequalities which exist in a socialist economy among the various occupations. He maintained that qualitative differences continue to exist among various types of work and remunerations are to be paid accordingly. This rationalises the difference of income which exists, say, between the manager and the worker, between the technocrat and the foreman, etc. The principle cannot be applied to evaluation of every individual's work and subsequent payment accordingly. There are two reasons for this: firstly, the exact amount of work performed by an individual and the contribution he makes to the social production process cannot be determined accurately; secondly, the introduction of material incentives may go against the principle itself by creating undesirable income gaps. The higher income

in a particular enterprise may not be the result of hard work and efficiency of its employees, but due to the external conditions favouring their production and distribution process. As has been noted earlier also, the techno-economic conditions of productions are different for different enterprises. So given these conditions of productions, the attempt to pay each according to his work, by bringing in material incentives is counterproductive.

It is true that in all the socialist countries steps have been taken to promote moral incentives and to expand political and ideological work among the people. But so far as the management of the economy is concerned, the political and ideological works do not seem to have any co-ordination with the economic methods applied to the management of the economy. Their overdependence on the technical solutions of the problems has led to a situation where the long term interest of socialism has been sacrificed to gain immediate economic benefits. It should be noted that even in a capitalist economy moral values play an important role "...between the worker and the management, the relationship incorporates a variety of complex non price relations including trusts, obligations and

a socially conditioned sense of duty. Indeed, only in rather limited areas of economic interest can it be said that interrelations between persons can be sensibly based on the pure pursuits of selfishness".¹ The legal provision to allow the capitalists to retain and use the profit earned, is not applicable to the workers, managers and other technocrats. The planners' preoccupation with the idea that the maximisation of personal material benefits is the sole aim of the managers and workers in a socialist economy has led to the negligence of the increasing consciousness of their social position. Whether it is in a socialist enterprise or in a capitalist one the managers and the technocrats especially identify themselves with the enterprise and their position and thereby develop some socially conditioned sense of responsibilities. Such values can be developed by intensive political and ideological campaigns. But the fruits of such works are unobtainable in the short run. So the planners in the USSR and in Hungary, in lure of immediate results, introduced material incentives and have developed the system to a level where only techno-

1. Amartya Sen, "Carrots, Sticks and Economics: Perception Problems in Incentives", Indian Economic Review, Vol. XVIII, No. 1, Jan-June, 1983, pp. 2-3.

economic solutions can be sought to correct any distortion.

Most of the problems whether resulting from the incentive system or from enterprise functioning have their roots in the central planning system. The planners had to think seriously to redefine the role of the enterprises. The abolition of the directive model does not alone solve the problem. The question that remains is what is the alternative. A political solution along with the introduction of the 'self management' type of model (as Brus suggests) is unacceptable for reasons noted earlier (see chapter I). The answer lies in the acceptance of the fact that all the decisions regarding investments, production and distribution need not be taken by the Centre. The plan should provide the basic guidelines to the enterprises. While major economic decisions should be taken by the central planners the less important ones can be taken by the enterprises themselves. This brings us close to Kornai's model.

To conclude, one would say that efficiency cannot be guaranteed by providing autonomy to the enterprises alone. Incentives have to play an important role. While material incentives are undesirable and go against the socialist values, given the objective conditions in

the USSR and in Hungary, where the use of moral incentives has not been effective and not much of attention has been paid to develop moral values (in comparison to the interest paid to the use of material incentives) the use of material incentives cannot be avoided at present. Even when material incentives are used, attempts should be made to increase the share of collective consumption in the total amount of material incentives offered. The idea of sharing things in common should be popularised through sustained and sincere political and ideological campaign. Efforts should be made to do away with the bonus system. This can be done by allowing sincere involvement of workers and managers in the decision-making process so that they can identify themselves with the interests of the enterprises. This is not only going to increase efficiency of the central planning system, but also will be an important step towards socialisation of the means of production.

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