Pathfinder

CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
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THE SOVIET ECONOMY: PART 2

In the last issue of the **Pathfinder** *we described the workings of the economic planning system used in the Soviet Union and how such planning violates individual preferences and creates waste and inefficiency. In this issue we discuss the role of the Soviet manager.*

The Soviet manager has a relatively simple job. He must keep the planners informed about the firm's productive capacity and its requirements for raw materials, labor and various other inputs. He must then make sure that the firm produces the planned output. The manager's job security, promotions, income and other privileges depend on his firm's fulfillment of the plan. Since he gets monetary as well as nonmonetary rewards for above-plan performance, the manager also has an incentive to do better than the planned output.

In theory, the Soviet manager has no decision-making powers that affect the value of the firm's output. He is a bureaucrat who is expected to do what he is told to do. In practice, Soviet managers have created for themselves some decision-making powers. To understand the working of the Soviet firm we must ask **how** and **why** Soviet managers are able to acquire these powers. The answer to this question explains the puzzle: how and why the Soviet economy can experience economic gains in an environment pregnant with waste, inefficiencies and indifference.

The Soviet manager, like his counterpart in the United States, wants to survive and prosper on the job. But the manager of an American firm has to compete in the marketplace. He is likely to have sleepless nights and develop heartburn and stomach disorders. Yet competition forces him to excel, to be alert to opportunities, to keep promises and to seek innovative investments. The American manager has to out-guess his competitors about other people's preferences and to satisfy those wants at the lowest cost. Competition is then a strict disciplinarian that channels people's energies in the direction of doing for other people what they want done for themselves.

The Soviet manager also has sleepless nights, heartburn and ulcers. His survival, however, depends on being alert to the Party's economic policy, Gosplan's (economic planning agency) preferences and local political conditions. The requirements of the economic plan channel the Soviet manager's energies in the direction of doing for others what the Party wants done for them.

To enhance his survival on the job, the Soviet manager has the incentive to (1) understate the firm's production capacity (to make attainment of his output quota easier) and (2) overstate the requests for supplies, capital and labor (to alleviate problems associated with late or inadequate deliveries). Of course, the planners know that they are being lied to, but it would simply be too costly for them to check the accuracy of each and every report they receive from managers.

The result is that the Soviet manager, moved by his own survival trait, creates for himself a degree of freedom which is equal to the difference between what the firm can do and what he convinces the state that it can do. Given the difference between the firm's true production capacity and its reported capacity, the Soviet manager can choose to produce no more than his output quota. In that case, the manager will accumulate supplies for future emergencies (e.g., for times when supplies do not arrive on time) but will forego monetary and nonmonetary rewards for above-plan production. Conversely, the manager can produce the highest output possible and collect the rewards. However, in doing that he would use up the allocated supplies. The manager can also choose a compromise of producing a little above the plan and accumulating some supplies.

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To accumulate supplies means to create an inventory of "unreported" stocks. The unreported stocks permit the firm to meet its output quota when the planned supplies fail to show up. Thus illegal inventories correct planners' mistakes, reduce production delays and alleviate inefficiencies in the system of planning.

But a Soviet manager can only accumulate supplies he actually receives. Suppose the plan allocates to the firm 100 units of *A* and 100 units of *B*. The firm needs, say 80 units of each to produce the planned output target. Let us assume that the firm receives all 100 units of *A* but only 5 units of *B*. The manager can report this short-fall to the authorities. However, he can do much better for himself (earning a bonus) and for the planners (saving them from having to readjust the plan) if he could somehow deliver the required output on time. And he can. The manager considers the surplus of *A* as a source of purchasing power. He will trade his surplus with other managers in what is known in the USSR as "informal" markets. Just like unreported stocks, informal markets serve an important function in the Soviet economy by correcting planning inefficiencies and mistakes.

Of course, the manager cannot go on forever accumulating inventories. First, there is a physical limit for storing supplies. Second, the manager does not want to overdo it — after all, it is illegal to accumulate unreported stocks. Thus the manager will eventually use his unreported stocks to overfulfill the plan. The state will then revise his output target and give him a higher output target for the next period. In the process the difference between the firm's true and reported production capacity will shrink.

Thus the very existence of a difference between the firm's true and its reported capacity is an essential survival requirement of the Soviet manager. In practice, it means that he has incentives to search for cost-saving improvements in order to offset the effects of a revised production target. The point of tremendous importance is that the Soviet system has a built-in incentive for managers to search for technical improvements if they can (1) conceal them from the state and (2) choose the rate at which these improvements are made known to the authorities (i.e., **via** overfulfillment of production targets).

Let us now summarize our discussion of the role of the Soviet manager in the USSR. The fulfillment of the economic plan depends, to a large extent, on the manager's ability to violate the plan. Through the process of lying about his firm's productive capacity and its demand for supplies, the manager accumulates **unreported** stocks either for future production needs or for exchange in informal markets. He also seeks technical innovations that could be concealed from the state. Since attainment of the ruling elite's economic objectives depends on its willingness to accept the manager's lying and cheating, the authorities do tolerate it. They must in order to keep the system going.

The following story, which is reprinted from a Soviet newspaper, confirms this analysis of the role the Soviet manager plays in making the system work. The story also shows that the state's tolerance of informal activities by managers has its limits.

Sotsialisticheskaia Industriia (Socialist Industry) of July 27, 1984, reports on a complex industrial bribery case in Bratsk that illustrates a commonplace situation in the USSR — pressured managers resorting to bribery in order to overcome production or logistics problems that interfere with state-mandated objectives. According to the article, the defendant Nikolayev explained: "Bratskgesstroy has had to operate in difficult conditions in recent years, conditions which arose in connection with the substantial above-plan targets imposed on us. The imbalance in the plan, holdups on the railroads, low delivery discipline — all this called for unusual, unconventional methods in resolving problems."

As a consequence, according to Nikolayev, "A policy aimed at establishing personal contacts and relations with staff at central departments and enterprises emerged as a result. Handing out so-called souvenirs to facilitate the resolution of production questions became widespread practice. On the instructions of administration chief Yatsenko, goods sent to Bratsk for production purposes were used to create a pool of the required articles. Hospitality, souvenirs, and presents at the state's expense — all this led to a free and easy attitude to material values and blunted and blurred the line separating the permissible from the impermissible." *(Reprinted from "Press Reports on Soviet Affairs," Advanced International Studies Institute, Washington, D.C., 8/24/84.)*

—Charles Maurice
—Steve Pejovich

(For more complete information on the quality of life in the USSR we recommend two books: G. Warren Nutter's **The Strange World of Ivan Ivanov** *(New York, World Publishing Co., 1968) and Steve Pejovich's* **A Report Card on Socialism** *(Dallas, Fisher Institute, 1979).* *We thank the Texas Education Association for a generous grant to support research on socialism.)*

WHAT DOES IT COST TO SAVE ONE AUTO WORKER'S JOB?

In 1980 the automobile industry posted a staggering loss of $4 billion, the largest in the history of the industry. In response to pleas from U.S. automakers and the UAW, the Reagan administration imposed a quota on Japanese imports which limited the number of Japanese-made cars that could be shipped to the U.S. This quota was recently lifted in spite of a great deal of opposition. To understand some of the issues involved, let's take a look at the history of the U.S. auto industry over the past few decades.

Before 1960, foreign imports accounted for less than 8 percent of U.S. car sales; by 1980 this figure had risen to more than 28 percent. While all the reasons why U.S. car makers lost so much ground to foreign competitors will never be known, we can identify several important factors. First, increases in the price of gasoline following the Arab oil embargo in 1973-74 sparked consumer demand for smaller, more fuel-efficient cars. Domestic price controls on oil had kept gasoline prices low, so U.S. car producers were not prepared to meet the increased demand for gas-efficient cars. Japan and other European countries, on the other hand, had lived with higher gasoline prices for many years and had full lines of fuel-efficient cars already on the market.

Second, the federal government imposed safety regulations and emissions controls on the industry in the late '60s. Complying with the safety regulations meant costlier, heavier and less fuel-efficient cars. Meeting the emissions controls deadlines led the industry to resort to some relatively inefficient quick fixes, which resulted in poor performance, severely depressed fuel economy and widespread consumer dissatisfaction.

Third, consumers believed foreign cars were built better. Unfortunately, the government push for lower emissions and safer cars came at the same time the industry was trying to downsize cars to meet consumer demand for fuel efficiency. Since foreign cars were already smaller and fuel efficient, foreign producers were perhaps able to meet regulatory standards more easily. Whatever the reasons, consumers believed imports were better made, and some evidence bears this out. When *Consumer Reports* compared frequency-of-repair records for imports and U.S.-made cars, there was little difference in the ratings in 1970, but by 1981 imports scored significantly better than domestic cars.

Fourth, production costs were higher in the U.S. than in Japan. Estimates indicate that Japanese auto manufacturers can make a car for $1,300 to $2,500 less than U.S. producers. The cost advantage stems mainly from differences in wage rates, productivity and management practices. In 1983, for example, hourly compensation for U.S. auto workers was $19.02, almost 60 percent above the average compensation for all U.S. manufacturing firms. In Japan, comparable compensation for auto workers was $7.91 per hour compared to $6.24 for all manufacturing firms, or only 25 percent more than the average Japanese industrial worker received.

Japanese cars had a price advantage, and many consumers thought they were better built than American cars. Import sales soared, and U.S. car producers lost billions. Against this background, the import quota was imposed. As with any supply restriction, the quota caused prices to rise.

Protected from foreign competition, U.S. producers sold more cars, but Japanese producers also benefited. Although their sales were limited, the Japanese tended to export cars loaded with options, which increased prices and limited choices by U.S. consumers. Moreover, the limited number of Japanese cars has sometimes allowed U.S. car dealers to charge premiums, at times as much as $2,500 above the sticker price. Thus, consumers bear the cost of the quota, while both domestic and Japanese producers gain from the higher price.

Quotas were intended to be a temporary shelter for U.S. producers while they adjusted to increased competition and federal regulations. During the interim, it was anticipated that car manufacturers would retool for new models, start major investment programs designed to modernize plants and lower their production costs, and possibly seek wage concessions from their highly unionized work force. These adjustments have apparently not occurred.

The quota was also intended to protect the jobs of American auto workers, and it has succeeded to some extent. (Domestic car sales are higher than they would have been without the quotas.) But the cost of saving these jobs should be emphasized. Robert Crandall estimates that the cost to consumers in terms of per job saved is $160,000.

From an equity viewpoint, consumers should ask why they should be asked to subsidize the U.S. auto industry and, in particular, jobs for American auto workers when auto workers earn more than the average American. Perhaps the Reagan administration asked the same question.

Jacqueline Browning
Associate Professor
Economics
Texas A&M University

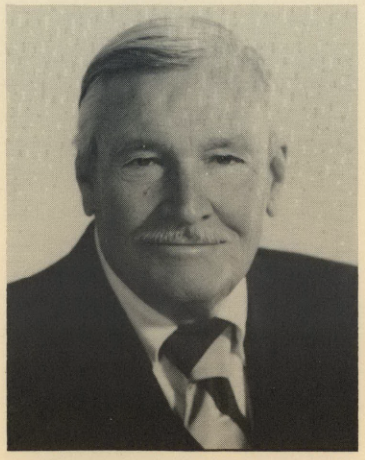
Many of the facts and figures in this article are from Robert W. Crandall, "Import Quotas and the Automobile Industry: The Costs of Protectionism," **The Brookings Review** , *Summer 1984, pp. 8-16.*

Profile

ADVISORY BOARD MEMBER B. V. THOMPSON JR.

Editor's note: The Center is pleased to welcome two new members to its National Advisory Board — Russell Perry and B.V. Thompson Jr. The February issue profiled Mr. Perry. This issue's Profile features Mr. Thompson.

Beverley V. Thompson Jr. is President of the Texas Educational Association in Fort Worth. He is a director of the Texas Steel Co. and the Liberty Co. Mr. Thompson was interviewed recently by Dr. Charles Maurice, Associate Director of the Center. Portions of that interview are printed here.



B. V. Thompson Jr.

Maurice: What do you see as the major accomplishment of the Center for Education and Research in Free Enterprise during recent years?

Thompson: Educating the general public and enhancing their understanding of free enterprise and the way the free enterprise system works. By and large the furtherance of knowledge about our system and its benefits is the greatest contribution.

Maurice: What do you see as the Center's major goal in the years ahead?

Thompson: How do you set and measure goals? Continue what you are doing. Do more of it. Raise the public's knowledge through more publications and seminars.

Maurice: In light of the recent election, do you see a long-term change in the attitude of the general public toward our free enterprise system, or is the election simply a one-time phenemenon?

Thompson: It definitely is a long-term change. It's a trend in the population as a whole. You can really see it in the trend toward conservatism on college campuses — so different from only 10 years ago. The foundation I now head was begun in 1940. For many years it was difficult to find conservative projects to support. Now we must pick and choose among many good projects.

Maurice: To what do you attribute this change in the public's attitude, especially among young people?

Thompson: Ideas take 20 to 30 years to have consequences. One thing has happened though. The obvious failure of socialistic programs has awakened people. These ideas just don't work.

Maurice: What is your major concern for the country today?

Thompson: Education is definitely a problem. But I do think the recent publicity about the past decline in the education system has awakened people. The Perot Commission report could have a good effect. Many of its recommendations may be decimated, but at least it's a step in the right direction. One problem is forced busing. Another is that the NEA (National Education Association) and other teachers' unions are placing teachers in an adversary position. These labor organizations are taking teachers out of the community.

* * * *

It will be a pleasure having Mr. Thompson on the Center's National Advisory Board.

THE OIL-PRICE MIRACLE

Did you celebrate an anniversary on January 28th of this year? Although it was not a legal holiday, you should have celebrated — unless you are an oil sheik. On that date four years ago President Reagan ended price controls in the U.S. petroleum industry and thereby ended the energy crisis.

Remember the energy crisis? It began with the Arab oil embargo in 1973 and climaxed with shortages and gasoline lines during the summer of 1979. What happen to all that panic, and to all the doom-and-gloom merchants predicting the end of a society based on fossil fuels? Put simply, the market happened.

When President Reagan announced the end of oil price controls, "experts" generally agreed that American consumers were about to be had. On the day following Reagan's announcement, *The New York Times* reported that "the cost of gasoline and heating oil is expected to rise," and the only disagreement was "about the amount." Prices did rise immediately after decontrol, but they soon began to fall, and they've been falling steadily since.

What the government had failed to accomplish through admonitions, controls and a DOE budget exceeding $9 billion, the market managed spontaneously in a few months.

By the end of 1981 consumption had dropped by 20 percent. Meanwhile producers were also responding to higher prices by finding more sources of petroleum. By the end of 1981 the number of oil rigs working in the United States was almost double the number in 1979. Thus domestic demand decreased and domestic supply increased. Prices had to decline—and they did. Gasoline prices are actually lower today than they were in 1981.

The once apparently invincible Organization of Petroleum Exporting Countries is now in disarray, unable to prevent price cutting by its members, much less by independent producers such as Great Britian and Norway. Its near collapse only supports what economic theory predicted all along: An effective cartel cannot long survive in a free market.

Thus the beginnning of the end of the energy crisis occurred four years ago — although at the time few analysts predicted the current happy state of affairs. Once the price mechanism was permitted to function — after a delay of 10 years — the gap between domestic energy consumption and production began to narrow rapidly. With increasing energy prices, consumption declined.

We might ask one question: Was it a miracle? Well, if one remembers those long gas lines back in 1979, the answer is yes. How else could so serious a problem go away in such a short time? And we would probably agree. Sometimes the results of freely functioning markets seem like a miracle. No one person, no government, no regulatory body was needed to solve the crisis. The real miracle was that individual consumers and producers, acting independently in their own self-interest, eliminated the crisis by responding to price changes.

So celebrate. Treat yourself. Go fill up your car and remember the gas lines and the predictions of prices above $2 that abounded four years ago. Then be glad the market works.

—Charles W. Smithson
Associate Professor, Economics

NEW MONOGRAPHS PUBLISHED IN PUBLIC ISSUES SERIES

Professional Staff Activities

In February, Dr. Pejovich attended Vienna Night In Washington, D.C., an event sponsored by the Organization of American States, the Committee for Western Civilization and the Archduke Otto Von Hapsburg. Phil and Wendy Gramm, Ed Fuelner and Bob Reilly were among the patrons for this event.

During the months of February and March the Center Director also attended a meeting of the Council for National Policy in California: a Liberty Conference on Industrial Policy in Key Biscayne, Fla., chaired by Karl Brunner: spoke to the Dallas Investment Club about free enterprise: and with Associate Director Maurice, flew to San Antonio at the invitation of Carl Raba to attend the annual banquet of the North San Antonio Chamber of Commerce. The special guest at the banquet was Rawles Fulgham, a member of the Center's National Advisory Board.

Larry Rose traveled to the Del Rio ISD in March to present a seminar on entrepreneurship and free enterprise.

Irving Public TV Series Continues

The latest Irving Public Television show focused on "Trends in Financial Markets."

The panel featured Rawles Fulgham, a member of the Center's National Advisory Board; Gene Zorn, a former Republic Bank chief executive officer; and Dennis McCuistion, an area financial consultant.

As with all the programs, copies of the show are available free upon request. Contact the Center for details on how to obtain them.

More Public Issues

The 10th, 11th, 12th and 13th issues of the *Series on Public Issues* are now available. Focusing on major social and political issues of the day, the authors apply simple, well-tested economic principles when discussing their views. Single copies of the series are complimentary while multiple copies are available at significant quantity discounts. Contact the Center to obtain a complete list of the series publications.

10th Issue: *Value and Opportunity: Comparable Pay for Comparable Worth* by Deborah Walker

11th Issue: *The Revolution in Banking and the Financial Services Industry* by Donald R. Fraser

12th Issue: *Industrial Democracy: Conflict or Cooperation?* by Steve Pejovich

13th Issue: *The Budget Deficit — The "Crisis" of the '80s* by Melvin L. Greenhut and Charles W. Smithson

Briefly Noted

- The Student Advocates for Free Enterprise group has been revived with the Center's help and is functional again on the Texas A&M University campus.
- The Center is taking an active role in assisting the establishment of new free enterprise centers in the states of Idaho, Ohio and South Carolina.

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Lawrence C. Rose, Research Assistant

Contributors of $5 or more receive *Pathfinder* for one year, teachers in elementary and secondary schools may receive *Pathfinder* without a donation.

INTERNATIONAL INCOME COMPARISONS

The following is a partial listing of the approximate work time the average manufacturing employee required to buy selected commodities in the U.S. and the Soviet Union during March 1982. The comparison is in minutes of work time. The source is a NFIB publication, called "What's the Difference?".

Item	Washington	Moscow
Bread (1 kg)	16	17
Hamburger (beef, 1 kg)	37	123
Sausages (1 kg)	33	160
Cod (1 kg)	61	47
Sugar (1 kg)	9	58
Butter (1 kg)	55	222
Milk (1 liter)	6	22
Cheese (1 kg)	100	185
Eggs (10)	8	55
Potatoes (1 kg)	7	7
Cabbage (1 kg)	9	12
Carrots (1 kg)	11	19
Apples (1 kg)	10	92
Tea (100 g)	10	53
Beer (1 liter)	11	16
Vodka (.7 liter)	61	452
Cigarettes (20)	9	15
Weekly Basket (hours) (Family of Four)	18.6	53.5

SUBSCRIPTIONS

If you know of people who would like to be added to the *Pathfinder* mailing list, just drop us a line and their names will be added. The *Pathfinder* is complementary to educators; others may obtain a year's subscription (six issues) for $5.

INFORMATION SOUGHT ON ECONOMIC EDUCATORS

The following survey is intended to measure teacher preparation in order to teach free enterprise economics. Please take the time to fill out and return this questionnaire to the Center. It will be beneficial to both present and future teachers in this field. The results of the survey will be reported in a future *Pathfinder* issue.

Please circle the most appropriate answer:

1. What are your total number of years in teaching?
   A. 0-3 D. 11-13
   B. 4-6 E. 14 and over
   C. 7-10
2. What are your total number of years teaching economics or free enterprise?
   A. 0-3 D. 11-13
   B. 4-6 E. 14 and over
   C. 7-10
3. At what grade level do you (or did you) teach economics or free enterprise?
   A. Primary D. College
   B. Junior High E. Post Graduate
   C. Secondary
4. How many hours in economics or free enterprise did you take in college?
   A. 3 or under D. 14-19
   B. 6-9 E. 20 or over
   C. 10-13
5. Did you receive your degree from an institution of higher learning in Texas?
   A. Yes B. No
6. Did the college that you attended offer any courses specifically designed for educators in economics or free enterprise?
   A. Yes C. Unsure
   B. No
7. When you first began teaching economics or free enterprise did you feel that you were qualified to do so?
   A. Yes C. Unsure
   B. No
8. Do you feel that a course or courses would have been (or will be) beneficial to those teaching economics or free enterprise?
   A. Yes C. Unsure
   B. No
9. If courses were made available specifically designed for economic educators, would you be interested in attending?
   A. Yes C. Unsure
   B. No
10. In what subject area was your degree?
    A. Economics E. Math
    B. History F. Political Science
    C. English G. Science
    D. Business H. Others (please list)
11. Where did you receive your degree if not in Texas?
12. Have you attended any seminars on economics or free enterprise? If so, where?
13. Please indicate your sex and age along with any further comments you would like to make.