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Soviet Economic Reform—Surprisingly Prescient

Robert E. Hamilton

ABSTRACT: Writing in 1971, economist Dr. John P. Hardt assessed the trajectory of the Soviet economy arguing the need for reform and evaluating the willingness of key actors in the Soviet bureaucracy to support such policies. Fifty years later, Hardt was remarkably prescient with regard to structural difficulties such reform posed and the costs of delay. The pervasive role of internal and external security concerns in the following decades, however, resulted in economic decisions that defied traditional economic analysis.

Predicting the future is hard. Predicting the future of a country Winston Churchill described as "a riddle wrapped in a mystery inside an enigma" is notoriously difficult.[1] Despite the growth of an entire class of so-called Sovietologists inside Western academic and policy circles by the late 1980s, few predicted the Soviet Union would collapse, and none predicted the precise timing and manner of its demise. Although many observers of the Soviet Union saw the need for reform by the 1980s, Dr. John P. Hardt was far ahead of the curve. Writing in *Parameters* in 1971, Hardt pointed out the need for reform of the Soviet economy, explained why such reform would be difficult, and concluded every year it was delayed the cost of these efforts would increase. To be sure, Hardt did not get everything right, but he got enough right that his article deserves re-examination for the lessons it still holds 50 years after its publication.

View from 1971

Hardt begins his article by noting Soviet Premier Leonid Brezhnev had announced in 1969 that improved economic performance was a "first order agenda item for the Party," setting off a fierce debate between proponents of a return to a "Stalinist heavy industry-military priority" and proponents of economic modernization focused on the civilian economy.[2] The problem was falling productivity. Unless productivity increased, Hardt believed labor shortages would inhibit fulfillment of the economic goals outlined in the Five-Year Plan for 1971–75. The solution was obvious: the release of able-bodied males from the armed forces. Such a policy would alleviate the labor shortages and buy time for the Soviet economy to modernize and accrue the accompanying gains in

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1. Winston Churchill, "The Russian Enigma" (BBC Broadcast, October 1, 1939, transcribed by The Churchill Society), http://www.churchill-society-london.org.uk/RusnEnig.html.

2. John P. Hardt, "Brezhnev's Economic Choice: More Weapons and Control or Economic Modernization," *Parameters* 1, no. 1 (Fall 1971): 43.

efficiency. While obvious, the solution was a tough sell inside the Soviet Communist Party due to the "pervasive military influence" there.[3]

Hardt saw two issues that might shape Soviet economic policy options moving forward. The first was the familiar "guns versus butter" debate—the tension between investment in the military and investment in growth-stimulating consumer goods. Here he thought the power of the Soviet military-industrial complex would mitigate against the reallocation of resources toward consumer goods. But Hardt saw another issue, one that cut across the guns versus butter debate. This issue pitted the economic professional interested in maximizing efficiency against the party functionary interested in maximizing control.

Hardt believed the emergence of a de facto alliance of economic and military professionals might overcome the resistance of party bureaucrats and allow for economic modernization. Economic and military professionals would be interested in maximizing both efficiency and their own ability to make decisions on resource allocation, free from central party control. As he explained it, "how to formulate economic plans to implement party policy and how to choose among military weapons systems to meet requirements of given missions are technical and professional tasks best performed by the professional institutional groups rather than the party bureaucrats."[4] In this case, the alliance of military and economic technocrats might be able to inject rationality and efficiency into the ideologically hidebound and sclerotic thinking that dominated Soviet economic planning.

Hardt believed how the guns versus butter and "control versus efficiency" issues were resolved would frame the economic choices available to future Soviet planners. He outlined three possible lines of development for the Soviet Union in the years after 1971. The first line was a return to the essential features of the Stalinist system of priorities, control, and administration. Hardt saw such a return as unlikely, mostly because he thought Stalin's system could not work without Stalin's terror, and Soviet leaders had lost the appetite for unleashing such terror on their society.

The next path he saw was a continuation of the equivocal, modified Stalinist system currently in place, in which the economy would still be focused on military and industrial production, but without the repressive measures of Stalinism. This outcome would mean "continued strategic-military emphasis with institutional stagnation or economic *immobilism* [emphasis in original]."[5] Hardt saw this path as problematic because it failed to address the core problem of stagnant economic productivity. Although he thought the emergence of a new, professionally trained planning cadre and managerial class might allow for increases in performance, he noted those increases would be modest without the

3. Hardt, "Brezhnev's Economic Choice," 46.
4. Hardt, "Brezhnev's Economic Choice," 45.
5. Hardt, "Brezhnev's Economic Choice," 51.

release of resources from the military sector and the delegation of authority from the party's center.

Finally, Hardt thought declining economic conditions might force the hand of party bureaucrats. The third line of development he outlined envisioned significant changes to the Soviet system. In this case, the policy-making elite would become more pluralistic and professional, and management of the economy would become more focused on efficiency and market stimulation. This transformation would not come about organically but as a response to an economic crisis.

> Economic crisis could force the shift from defense expenditures to growth-stimulating ones that would not otherwise be made. In other words, the shift from defense might be resisted on policy grounds but be taken as the only viable economic alternative. Economic crisis could likewise bring about a shift of control to the economic planners and managers in the quest for recovery.[6]

Hardt concluded by arguing the longer the Soviet elite delayed addressing its economic issues, the more difficult these issues would be to resolve. In perhaps the most prescient sentence of the article, he concluded "the cost of equivocation is high and rising."[7]

Evaluating Hardt

Hardt was correct on many counts. He understood declining productivity and the looming labor shortage were serious problems. He grasped that the pervasive influence of the military over the economy was going to make reallocation of manpower from the military to the civilian economy difficult and would complicate the shift from military-industrial production to growth-stimulating consumer goods. He also seemed to perceive that, writing in 1971, he was standing at an inflection point in history, something difficult to do in the moment.

With the benefit of hindsight, the economist Robert C. Allen says the Soviet economy grew rapidly from 1928 to around 1970 because it "accumulated capital and created industrial jobs for people otherwise inefficiently employed in agriculture."[8] After 1970 the growth rate dropped abruptly for internal and external reasons—externally the Cold War diverted resources to the military, cutting the rate of productivity growth; internally the end of the surplus labor economy choked off growth. By 1970 "unemployment in agriculture had been eliminated and the accessible natural resources of the country had been fully exploited."[9] The fact that Allen, writing in 2001, agreed with the main conclusions Hardt arrived at 30 years earlier speaks to the prescience of the latter's analysis.

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6. Hardt, "Brezhnev's Economic Choice," 52.
7. Hardt, "Brezhnev's Economic Choice," 52.
8. Robert C. Allen, "The Rise and Decline of the Soviet Economy," *Canadian Journal of Economics* 34, no. 4 (November 2001): 878.
9. Allen, "Rise and Decline," 878–79.

Hardt understood military spending was a drag on Soviet economic growth, and that the strength of the military in Soviet policy-making circles would impede the reallocation of resources toward more productive ends. But he did not think change was impossible, arguing the emergence of an alliance of military and economic technocrats or an economic crisis could provide the catalyst for reform. This perspective turned out to be too optimistic. Had Hardt delved more deeply into the reasons for the military's dominance in policy making he would have been more pessimistic about the ability of the Soviet system to right itself—the outsized role of the military in Soviet policy making was itself the effect of the Soviet government's understanding of the world and the Soviet Union's place in it.[10] So diverting resources from security spending to more productive purposes would not just involve a realignment of policy priorities but a shift in the Soviet government's entire worldview.

This worldview saw Soviet security as constantly under threat and believed superior military force was the only way for the country to survive. The economist Mark Harrison argues national security considerations were decisive at every point in Soviet decision making. In the Bolsheviks' understanding of the world, they faced dual threats from an external enemy and an internal enemy, and these enemies colluded with and reinforced each other. To meet these threats, the economy was organized to "mobilize against the foreign enemy and suppress the enemy within."[11]

Forced industrialization allowed mass production of military machinery. Forced collectivization prevented farmers from starving the towns and the army. And mass killings eliminated "potential enemies," those who would "cheer the leaders when it was costless to do so but would betray them in time of war."[12] Western economists called the Soviet economy a command economy because it directed efforts to a few public priorities, imposed rigid quantitative controls on the entire supply chain, and suppressed private motivation in favor of patriotic appeals and direct compulsion. But Polish economist Oskar Lange noted "this was what every society now did in time of war. What called itself socialism . . . was really a 'war economy.' "[13]

In an economy on a permanent wartime footing, it is unsurprising the military played an outsized role in decision making. Historian Chris Miller gives a revealing account of the military's role in economic policy making. Not only could the military claim to be defending the country from "capitalist aggression," but it employed some 15 million people (around 10 percent of the total workforce), conducted 75 percent

10. Mark Harrison, "The Soviet Economy, 1917–1991: Its Life and Afterlife," *Independent Review* 22, no. 2 (Fall 2017): 202.

11. Harrison, "Soviet Economy," 201.

12. Harrison, "Soviet Economy," 201.

13. Harrison, "Soviet Economy," 202.

of the country's scientific research, and used 60 percent of its steel.[14] Even before Mikhail Gorbachev came to power in 1985—14 years after Hardt warned equivocation would raise the cost of addressing the USSR's economic problems—the need for reform was urgent and was obvious to some in the Communist Party. But according to Gorbachev the power of the military was such "that even a mention of [cutting the defense budget] would mean immediate dismissal" from the party.[15]

The military also resisted attempts to make its budget more transparent. When Gorbachev finally managed to gain a complete view of Soviet defense spending in 1987, he expressed his frustration that "military expenditure was not 16 per cent of the state budget, as we had been told, but rather 40 per cent."[16]

But the military was not the only impediment to reform. Miller details the rise of two additional bureaucratic-economic interest groups that together with the military-industrial complex had come to dominate party policy making by the 1980s. These were the agro-industrial complex and the fuel-energy complex. Inside these three complexes, economic bureaucrats and industrial interest groups developed power bases and patronage networks that allowed them essentially to implement their own policies, sometimes in opposition to those directed by the Kremlin.[17] Officials often spent their entire careers within the same sector, creating "interconnected webs of relationships, favors, and loyalty."[18]

Like the military, the agricultural and energy sectors argued they were critical to the state. The agricultural sector noted it employed millions of citizens and highlighted the Soviet propaganda that portrayed collectivization as "one of the great successes of socialism."[19] The energy complex proclaimed it provided the bulk of the country's export revenue.[20] As Miller concludes, Gorbachev's basic dilemma was the economic sectors that most needed reform to balance the budget had the power to prevent that reform.[21]

The fact Hardt failed to understand the power of the three bureaucratic-economic interest groups that foiled attempts to reform the Soviet economy is not surprising for two reasons. First, when Hardt was writing in 1971 the power of the military-industrial and agro-industrial complexes was already significant, but neither had yet gained the ability essentially to capture the state budgeting process. The fuel-energy complex only gained prominence after the 1973 oil price spike.

14. Chris Miller, *The Struggle to Save the Soviet Economy: Mikhail Gorbachev and the Collapse of the USSR* (Chapel Hill: University of North Carolina Press, 2016), 59.

15. Miller, *Struggle to Save*, 59.

16. Miller, *Struggle to Save*, 60.

17. Miller, *Struggle to Save*, 57.

18. Miller, *Struggle to Save*, 58.

19. Miller, *Struggle to Save*, 59.

20. Miller, *Struggle to Save*, 59.

21. Miller, *Struggle to Save*, 180.

Figure 1. Soviet Union and Russa Military Spending
Source of data: US Arms Control and Disarmament Agency, World Military Expenditures and Arms Transfers 1966-1975 (Washington, DC: US Arms Control and Disarmament Agency, Department of State, 1976), https://2009-2017.state.gov/documents/organization/185668.pdf; and Stockholm International Peace Research Institute (SIPRI), "SIPRI Military Expenditure Database," SIPRI (website), https://www.sipri.org/databases/milex.
(Map by Pete McPhail)

Predicting these three groups would together gain enough power to strangle attempts at reform would have taken a special gift for prophecy.

Next, as an economist Hardt would presumably have expected the Soviet government to make a value-maximizing decision. He said as much when he wrote, "the Soviet economy is likely . . . to find economic performance a factor influencing sharp revisions in resource allocation—especially from defense to investment—and a significant increase in the permissive environment for economic reform."[22] But plenty of research in political science, such as the work of Graham Allison, Philip Zelikow, and David Houghton, explains why governments often make non-value-maximizing choices.[23] One of these explanations focuses on the role of government bureaucracies and their tendency to equate their own interest with the national interest—a phenomenon clearly visible in Miller's discussion of the role of the three bureaucratic-economic interest groups in preventing reform.

Hardt got one final observation right, and it is substantial. He correctly predicted a return to the Stalinist system of priorities, control, and administration was unlikely because it would require a return to Stalin's tactics of terror, something the Soviet Union was not ready to relive. In Hardt's words, "the author does not believe that the Stalinist terror could be reinstated again, nor that the leaders of a complex, more modern Soviet state could or would pay the price of depriving their society of its professionals and thinkers."[24]

Miller agrees, observing that the political class, which had suffered through Stalinism and the Second World War, welcomed Brezhnev's policy of stability at the top level of the party as a respite from the fear and violence of Stalinism. But what neither Hardt nor Brezhnev could have foreseen was the effect this policy would have on the Soviet economy. As Miller writes, "in Stalin's state socialist economy, violence played the same role that market incentives play in a capitalist economy—a means of ensuring that workers and managers work hard and effectively."[25] When the threat of violence faded, so did the incentive to meet the increasingly ambitious economic targets in the Soviet Five-Year Plans. Soviet economic performance suffered as a result.

Conclusions and Lessons

Any author writing in *Parameters* today would be gratified to have his or her work stand the test of time as well as Hardt's article has. He saw the need for reform of the Soviet economy before most Western observers did. He also understood the role of the military would complicate that reform, and each year of delay would raise the cost and lower the chances of success in modernizing the Soviet economy.

22. Hardt, "Brezhnev's Economic Choice," 45.

23. Graham Allison and Philip Zelikow, *Essence of Decision: Explaining the Cuban Missile Crisis*, 2nd ed. (New York: Longman, 1999); and David Patrick Houghton, *The Decision Point: Six Cases in U.S. Foreign Policy Decision Making* (Oxford, UK: Oxford University Press, 2012).

24. Hardt, "Brezhnev's Economic Choice," 51.

25. Miller, *Struggle to Save*, 56.

Perhaps most impressively, he seemed to understand he was writing at an inflection point: from 1928 until 1970 the Soviet economy had grown rapidly but began to decline in the 1970s. That decline accelerated in the 1980s, ending with the economic and political collapse of the Soviet Union in 1991.

Writing in 1971 when many analysts—including Nobel Prize winner Paul Samuelson—expected the Soviet economy eventually to overtake that of the United States, Hardt was much less sanguine.[26] He correctly identified the serious structural issues Soviet planners would need to address and the challenges to doing so.

Hardt did not get everything right. Although he identified the influence of the military as an impediment to reform, he failed to understand how strong an impediment it was. He also failed to address the reason for the military's outsized influence—the pervasive fear of external and internal enemies colluding to bring down the Soviet Union. This fear injected national security considerations into normally mundane issues like industrial and agricultural policy, seriously distorting Soviet economic decision making. Finally, as an economist Hardt would have been trained to expect the Soviet government to select policy options that maximized economic performance. But time after time the Kremlin was unwilling or unable to do so until it was too late. As Hardt had predicted, the cost of equivocation was indeed high.

Modern Russia is not the Soviet Union. Nevertheless, some of Hardt's insights are valuable today. Like the Soviet Union of the 1970s, Russia of 2021 is faced with declining economic performance. After rising rapidly from 2000–7, Russian GDP per capita flattened due to the combined impacts of the financial crisis that began in 2008 and Western sanctions imposed in 2014. In 2019 Russians were essentially no richer in real terms than they were in 2008: Russian per capita GDP in 2008 was $11,088, and in 2019 it was $12,012.[27]

Also like the Soviet Union, Russia's economic problems are structural. In the 1970s, the problem was a labor shortage; in 2020 the problem is Russia's hydrocarbon-dependent economy, which provides rents that stifle investment in other sectors and leaves Russia vulnerable to oil price fluctuations it cannot control. Finally, as it was in the Cold War, today's Kremlin is fixated on the idea of collusion between external and internal enemies. The ceaseless fight against these phantom threats gives the Russian military and security services outsized roles in Kremlin budgeting and policy making, leaving fewer resources for addressing Russia's real economic and social problems.

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26. Ian Harvey, "The Nobel Economist Who Predicted the Soviet Economy Would Overtake the U.S.," Vintage News, August 23, 2018, https://www.thevintagenews.com/2018/08/23/soviet-gnp/, last accessed November 11, 2020.

27. Trading Economics (website), "Russia GDP per capita," https://tradingeconomics.com/russia/gdp-per-capita, last accessed November 11, 2020.