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East Europe Report

ECONOMIC AND INDUSTRIAL AFFAIRS

(FOUO 5/81)



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CZECHOSLOVAKIA

INFLUENCE OF BANKS ON CAPITAL ASSET REPLACEMENT DISCUSSED

Bratislava EKONOMICKY CASOPIS in Slovak No 2, 1981 pp 118-127

[Article by Pavol Gallo: "The Influence of Banks on the Reproduction of the Enterprises' Capital Assets"]

[Text] The banks as credit organs are able to influence the reproduction of the enterprises' capital assets only through credit, by using it as an objective economic category--as the form of solving the contradiction between the production time and turnover time of goods, or between the need and temporary shortage of resources, in accordance with the sources of the individual types of credit, with the duration for which these sources are made temporarily available, and with interest as an essential element of credit.

Such influence by the banks has certain specific conditions. The banks' activity is strictly defined, and they may not depart from it. Their activity can neither be narrowed nor broadened arbitrarily. Their place or task within the economy is accurately defined, similarly as the task of the production enterprises to produce goods, and the task of the trade enterprises to arrange for the exchange of the produced goods. All economic units must fulfill their task, consistently employ cost accounting and, in their relations with the banks, see to it that credit is used in accordance with its intended purpose. At the same time the agencies that supervise the enterprises, and the central organs must create the conditions necessary for the smooth operation of the enterprises.

This is the aspect from which we must approach also the solution of such problems in the area of capital asset reproduction as, for example, inadequate utilization of existing capital assets, assertion of the requirements to modernize, reconstruct and renew capital assets, the use of credit to finance the replacement of capital assets, etc.

The solution of these problems requires that we analyze the basic questions of the enterprises' cost accounting as a prerequisite for effective influence by the banks, the creation of conditions for the smooth operation of the production process as an essential element of the normal application of cost accounting, the utilization of credit, and finally the questions of

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the forms in which the law-conforming influence of credit manifests itself, with special attention to the influence of credit on the reproduction of capital assets.

1. Basic Questions of the Enterprises' Operation Under Cost Accounting as a Prerequisite for Effective Influence by the Banks

Socialist enterprises are obliged not only to preserve, but also to systematically expand the economic assets entrusted to them by society. This obligation stems from the objective economic law of expanded socialist reproduction.

Admittedly, the productive forces do not develop evenly in every branch. This applies also to the reproduction of a highly efficient structure of the national economy. In a given year, therefore, the level of the productive forces cannot be the same in all branches, sectors and enterprises of even a specialized national economy with a highly efficient structure. The necessity of reproducing the productive forces at the world level in all branches, however, leads to their systematic equalization. Which means that here, over a period of several years, the rate of return can and must be the same.

The requirement of the same rate of return over a period of several years is determined also by the fact that all economic units must utilize their productive forces equally, and thereby contribute equally to expanded social reproduction. After all, it would not be right if society did not require identical results from all economic units operating under identical conditions. Finally, an identical rate of return is also an objective criterion for evaluating the work of the enterprises.

It is not easy to create for all the socialist enterprises such conditions of operation that enable us to demand identical results of them, nor is this a problem that can be solved once and for all. However, this should be one of the basic features of the overall concept of building a socialist economy, an economy of a higher socioeconomic system.

If we were to allow persistent mismanagement of the socialist enterprises and the elimination of such mismanagement by liquidating them, this would also mean the absence of accountability for enterprise employees, the toleration of a situation in which some enterprises survive at the expense of others. This would disrupt the economic mechanism and lead to socioeconomic problems.

The means for preventing such problems is the economic-financial system for the socialist enterprises' operation, i.e., cost accounting as an objective economic category of the socialist economy. At present, however, measures are necessary to enforce cost accounting and ensure its consistent application, so that it may become a system that excludes any absence of accountability and creates conditions for comprehensive incentives to stimulate maximum output and economic efficiency.

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The objective economic law of distribution in accordance with the work performed, which aims to satisfy legitimate needs, applies to individuals as well as to groups of workers and enterprises. Furthermore, the enterprises can obtain through exchange only the equivalent of what they produced.

If the enterprises are to survive and develop further, which is simultaneously a condition of expanded socialist reproduction and of society's development, they cannot report arbitrary outputs. The enterprises themselves cannot set the criteria of their own activity. These criteria are determined by the requirements of society as a whole, incorporated in a system of criteria for deciding the allocation of material and financial resources, for evaluating and stimulating the enterprises. Credit conditions also belong in this system of criteria.

In order to preserve the economic assets that society entrusts to the enterprises for reproduction and further growth, the losses occurring at the enterprises must necessarily be reimbursed as they arise--immediately and with appropriate accountability of the individual employees or groups of employees who caused the losses. This presupposes certain conditions, namely: strict definition of the activity of every employee, skills commensurate with the assigned work, continuous control of the work performed, appropriate resources for stemming the "loss process," and existence of contingency funds or insurance funds for employees and groups of employees.

In agreement with the principles of cost accounting, the enterprises must form the objectively necessary funds of monetary resources, utilize the temporarily idle monetary resources of these funds, and finance through credit the enterprises' temporary need of financial resources.

The funds of monetary resources in question are as follows: (a) for replacing the worn-out economic assets, and partially for manpower reproduction; (b) for the expansion of economic assets, and partially for the expanded reproduction of manpower, for increasing the size of the work force and upgrading its skills; (c) for financing joint needs and the needs of society as a whole; (d) for financing losses and unforeseen needs -- losses resulting from natural disasters, and other losses not attributable to the enterprise employees.

The enterprises must use the monetary resources of their formed funds in the same way as their other economic assets, to attain the same rate of return. The form of their use (motion) is objectively given. This form is credit. Through the banking system (by means of deposits on bank accounts), the enterprises lend their temporarily idle monetary resources to other enterprises that are able to use these temporarily idle resources at the given time. For at every enterprise, due to the unevenness of the economic processes, there occurs a contradiction between the production time and turnover time of goods, respectively between the need and temporary shortage of monetary resources.

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In principle, the enterprises could always finance their expanded reproduction from their internal resources (depreciation, profit, and the proceeds from the sale of capital assets) and from credit. It is merely necessary to form the conditions for this. In agreement with cost accounting, the enterprises should be allowed to retain the entire amount of depreciation. Even if occasionally the output of certain goods is curtailed, it is not absolutely essential to reduce the economic assets of the enterprises, provided the enterprise collectives take over other production programs.

From their internal resources and by using credit, the enterprises could finance also large investment projects. They only have to be enabled to gradually accumulate resources, primarily from depreciation and profit. A no small source of financing could also be the proceeds from the sale of capital assets that the enterprises do not need for the fulfillment of their production tasks, of capital assets that are obsolete or worn out, and of unused and unneeded capital assets held in reserve. Of course, the allocation and use of enterprise profit would have to be modified, in accordance with this solution for financing the long-term development of the enterprises.

In the case of large investment projects--e.g., construction of a new plant--it would be possible to use also credit on a large scale. It would be repaid not only from the relatively high profit of the newly built plant and its depreciation, but also from the profit and depreciation of the entire enterprise.

A further comment should be added to the question of using the temporarily idle monetary resources of the enterprises. In a departure from present practice, the enterprises should be able to use these temporarily idle monetary resources for any planned need, regardless for what purpose the monetary resources are intended. At present, for example, credit for the expanded reproduction of working capital is being repaid with the monetary resources disengaged from the turnover of working capital, and with that proportion of profit which is allocated for the increase of working capital. In addition to these sources, an enterprise should be allowed to use any of its temporarily idle monetary resources to repay the credit. This means also the monetary resources intended for the reproduction of capital assets.

Failure to use all temporarily idle monetary resources is in conflict with the necessity of fully utilizing internal resources, with the possibility of reducing production costs, and with the efforts of the enterprises to attain the highest possible (deserved) profit. Namely the enterprises lose the difference between the interest that they pay on credit, and the interest that they receive on their temporarily idle monetary resources deposited with a bank.

Any regulation of the enterprises' financial management that separates the monetary resources intended for the reproduction of capital assets, from

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the monetary resources earmarked for the reproduction of working capital, results in that an enterprise must apply for credit even when it has sufficient monetary resources on its account with the bank.

Separation of the monetary resources for the reproduction of capital assets, from the monetary resources for the reproduction of working capital, stems from an effort to thoroughly ensure the planned proportions of both types of economic assets of the enterprises, and thereby also the planned proportions of the entire process of social reproduction. This same objective, however, could be ensured also without the mentioned administrative regulation.

The monetary resources that are disengaged from the turnover of capital assets and are intended for their reproduction could be used also for the reproduction of working capital, because such monetary resources will be temporarily idle at some enterprises only if the planned proportions are observed. Similarly the monetary resources that are disengaged from the turnover of working capital and are intended for its reproduction could be used also to acquire capital assets in their physical form. In this way the unnecessary operations could be eliminated that complicate the work of both the enterprises and the banks.¹

¹The application of cost accounting in enterprise management contributes in large extent toward ensuring the continuity of the reproduction process, but at the same time it presupposes that the enterprises' supervising agencies and the central state organs form in a planned manner the conditions for the proportional development of the national economy. The quality of the national economy's planning and management must be improved, the questions concerning the competence and managing activity of the enterprises' supervising agencies must be resolved, the shortcomings must be eliminated in cooperation among investors, planning and design institutes, and contractors, etc. The solution of these and similar problems, the creation of conditions for the continuous supply of the enterprises and for ensuring their needs in general, for the smooth course of the entire process of social reproduction and of the aggregate social product's realization, are a prerequisite for the normal application of cost accounting and the influence of bank credit. These problems were discussed in detail at the sixth session of the CPCZ Central Committee, in 1977. See: "Report of the CPCZ Central Committee Presidium on the Construction Industry. J. Kempny: The Great Mission and Responsibility of the Construction Industry for the Further Development of the Economy and of Society" (PRAVDA, 18 March 1977).

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2. Basic Questions of Using Credit, Primarily for the Reproduction of Capital Assets

Credit is the form of resolving the contradiction between the production time and turnover time of goods. It serves to bridge the temporary financial needs of the economic units.

Through credit, a creditor economic unit temporarily lends certain resources to a debtor economic unit. If the borrower were to retain the resources longer, the creditor economic unit would be short of resources. It would have to curtail operations and cut back its activity, and even the supply of the needs of individuals would be limited.

If the debtor economic unit were to permanently retain the resources, the creditor economic unit's activity and the satisfaction of its needs would be permanently reduced by the amount loaned. The credit relationship would change into some kind of financial relationship, a sort of subsidy. The difference would be merely that the creditor economic unit would receive interest on the loan.

One might object that not all resources provided as credit must be repaid within a certain time. The own resources of banks are cited as an example. Such cases, however, are not intrinsic to credit, especially not under socialism.

Nor are such cases unavoidable, provided the banks have their own resources intended only for lending. The state alone can allot the enterprises credit to finance their permanent need of resources. The banks--similarly as the production, trade and other enterprises--must merely have reserve funds to cover possible losses.

The reserve funds, which should be formed only to the amount of the possible losses and should be used to cover these losses, are temporarily idle resources by their very nature. Therefore the reserve funds, too, should be used to provide credit, but not credit to finance the permanent needs of the economic units.

The mentioned facts justify the conclusion that it is economically unwarranted to substitute credit for the internal resources of the enterprises, or to finance partially or entirely with credit their permanent needs. This applies to all enterprises, and hence also to construction and installation enterprises that undertake capital construction.

It is likewise improper not to use credit to resolve the contradiction between the production time and turnover time of goods. Failure to do so would mean disregarding two economic and financial categories: the economic units' internal resources intended to finance their permanent needs, and credit intended to finance their temporary needs.

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The volume and structure of credit are determined by the volume of the sources of credit and by their structure that expresses the structure of material values whose flow credit is intended to mediate. Which means that the banks cannot provide any arbitrary volume of credit in any arbitrary structure. They can provide only the volume of credit and in the structure that correspond to the sources of credit and the sources of the individual types of credit: the sources of credit for the reproduction of capital assets, working capital, durable consumer goods, and nondurable consumer goods.

The banks cannot provide credit for any arbitrary length of time, only for the term determined by the factors of the individual types of credit.

Repayment of the credit within the agreed term can be secured primarily with monetary resources disengaged from the turnover of the credit-financed plant, by insuring the credit-financed plant, by providing credit only directly to the credit applicant, by assuming a guaranty for the debtor, and by employing the principle of a single crediting organ.

Credit is being used at present not only to resolve the contradiction between the production and turnover time of goods, but also to finance a part of the enterprises' permanent need of working capital. The main argument offered to justify this practice is that the bank's credit relations with the enterprises is broadened in this manner, enabling the bank to exercise closer control over the operations of the enterprises.

This practice disregards two objective economic categories: credit, and cost accounting. Here credit is used on an artificial basis, and from the positions of subjective views. Credit, by its very nature, is intended merely to resolve the contradictions between the production and turnover time of goods, respectively to finance the economic units' temporary needs, and bank control of the economic units can be exercised only on the basis of credit arising in this manner.

Starting out from the mentioned practice, the most extensive and most intensive bank control would exist if all internal resources of the enterprises were replaced by bank credit. The approach up to now makes this possible, because the limits of credit have been exceeded. The substitution of credit for internal resources was employed extensively in the past. But it was justifiably criticized, and rejected as improper and inefficient.

Cost accounting is being violated at present by the fact that credit is being forced on the enterprises, and they must pay interest on it. Credit is often used also to let bank control fill the gaps in the application of cost accounting, to supplement the inadequate self-interest of the enterprises in their operations. Instead of creating the conditions for compliance with cost accounting, and of elaborating the questions of the enterprise employees' monetary incentives and accountability in general, the

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bank's work is thus substituted for the practical activity of the enterprises. At the same time it is clear that the bank cannot do the enterprises' work for them. Credit and interest, no matter how high, will never have the necessary effect if the enterprises do not fully comply with cost accounting, if they do not keep track of every koruna. This again requires breaking down the system of monetary incentives and accountability to every employee of the enterprise.

If we consider the entire reproduction process and the bank's role, credit must be provided for the enterprises with due respect for the essential proportions of the social reproduction process, i.e., only from the temporarily idle monetary resources of other enterprises. Here the amount of credit for the reproduction of capital assets is determined by the monetary resources disengaged from the turnover of capital assets and by that proportion of profit which is earmarked for the expanded reproduction of capital assets. In other words, credit for the reproduction of capital assets must be provided from the monetary resources that the enterprises accumulate or must accumulate, for the renewal and particularly for the expanded reproduction of their capital assets, and for their development in general.

The volume of the sources of credit for the reproduction of capital assets simultaneously determines also the objectively necessary proportion of such credit within the sources for financing the reproduction of capital assets, or the enterprises' capital construction.

The use of credit for individual investment projects, just as of all the other sources for financing investments, stems primarily from the need of building a highly efficient structure of the national economy, in combination with international economic integration, and from the place of the national economy within the complex of the CEMA community's economy.

Under conditions when it is inevitable that the enterprises equally utilize their economic resources and attain a certain rate of return, the investor enterprises themselves can ensure--with the effective assistance of their supervising agencies and of the central managing organs--maximally efficient utilization of all economic resources, and hence also of the sources for financing investments, including credit.

It is questionable whether the banks, even if they were to specialize by individual branches and sectors, could better master the problems of the investor enterprises than these enterprises themselves and their supervising agencies. The banks could hardly do so even if they had the appropriate experts--mechanical, chemical, agricultural engineers, etc.--because the employees of an enterprise know best its problems and have, or should have, monetary incentives based on the enterprise's operation.

After such a thorough review of an investment projects, in combination with monetary incentives and accountability, the use of credit as one of the sources for financing investments is incorporated in the plan that the competent organs approve.

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Finally, a prerequisite for the proper use of credit is the application of cost accounting at the banks.

The application of cost accounting as an objective economic category of the socialist economy is not a matter of arbitrary choice. It must be employed wherever the objective needs so require. In general these needs can be defined as the needs of distribution, in accordance with the objective economic law of distribution based on performance. Which means that cost accounting must be used, necessarily and unavoidably, in the entire sphere of production as well as in the entire sphere of circulation--in trade and within the financial (banking) system. On the other hand, it cannot be employed in the area of public consumption or, more accurately, in the area of publicly financed consumption.

The application of cost accounting by enterprises in the sphere of production is generally recognized. Its use by trade enterprises is likewise recognized. Unclarified remains only the question of using cost accounting in financial institutions, insurance enterprises and in banks. Therefore it will be desirable to at least point out the basic facts that determine the use of cost accounting in banks.

The activities of production enterprises, trade enterprises and banks are mutually intelinked. If the social reproduction process is to proceed smoothly and in conformity with the plan, the trade enterprises must mediate the exchange of a growing volume of produced goods, and the banks --on the basis of the increasing sources of credit and demand for credit--must mediate a growing volume of credit that is objectively given by the increasing volume of output. Production enterprises, trade enterprises and banks create an integral whole, and therefore they must have an equal self-interest in the fulfillment of their tasks.

The banks are responsible for ensuring that the credit relations do not exceed the period of time for which the sources of credit were made temporarily available.

The mediation of credit constitutes the banks' output. It involves operating costs--expenditures of live labor and embodied labor--that must be recovered. The banks' development requires appropriate resources--i.e., profit--in the same way as at other enterprises in the spheres of production and circulation.

From the mentioned facts it follows that it is desirable to employ cost accounting at banks. This is generally recognized also in practice. In all socialist countries, the banks have cost accounting incorporated in their statutes. Its application, however, raises several open questions, but these are not peculiar to banks alone.

Consistent application of cost accounting in the spheres of production and circulation requires solving particularly the question of pricing, the use of depreciation by the enterprises, the share of profit that the enterprises

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may retain, the system of the individual employees' monetary incentives and accountability, and the use of insurance as an objective economic and financial category.

3. The Forms in Which Bank Credit's Regular Influence on Enterprise Operations Manifests Itself, With Special Attention to the Reproduction of Capital Assets

Bank credit can exert effective influence only if cost accounting and a system of monetary incentives and accountability--in a breakdown by individual employees--are consistently employed at the enterprises, parallel with forming and observing the proportions of the process of social reproduction, during the social product's continuous realization and with the use of credit as an objective economic category. The forms in which this influence manifests itself are diverse. Let us mention at least the principal aspects of bank credit's influence in the reproduction of the enterprises' capital assets.

If the enterprises are to attain a certain profitability, they must fully utilize their existing capital assets (operating them in two or even three shifts per day), and they may expand their capital assets--with the possible use of credit--only if their profitability will develop favorably.

While providing monetary incentives for every employee, the enterprises intensively and systematically apply the principles of comprehensive socialist rationalization, modernize, reconstruct and renew their capital assets, and flexibly replace their old and obsolete capital assets with more efficient ones. They do not always have sufficient internal resources to do so, and in such cases credit can be of considerable help to them. If the investment projects are very efficient and offer a high rate of return, the bank may provide credit even if the enterprises do not contribute any internal resources.

Highly efficient investments are usually the ones that permit rapid practical application of advances in science and technology, rapid growth of the formation of material and financial resources, savings of manpower, and a rise in the social productivity of labor.

The effect of credit, its contribution to the enterprise, stems from the fact that expanded reproduction of economic resources can take place even when the enterprise does not yet have sufficient internal resources for this purpose, and that credit--through its share in financing the expanded reproduction of economic resources--contributes toward improving the enterprise's economic results. In general the effect of credit could be measured by comparing the situations of two enterprises of essentially the same size, at the beginning and the end of a given period, where one of the enterprises uses credit while the other does not. Although this is a theoretical study, in principle it comprehensively defines the efficiency of credit.

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The effect of credit multiplies with the growth of investment projects, provided they are efficient projects. At present this applies particularly to investment projects that serve to gradually develop a highly efficient structure of the national economies in the individual socialist countries, and simultaneously a highly efficient structure of the economy of the CEMA community.

A highly efficient structure of the national economy makes it possible to resolve the contradiction between the growth of large-series production and the domestic market's limited purchasing power. In the same manner it resolves also the contradiction between the need to rapidly develop the productive forces on the one hand, and the practical inability of a single country to develop all the necessary branches of science, technology and production. With the realization of a highly efficient structure of the national economy, the social productivity of labor rises at a fast rate. This permits the formation of real sources of credit, which are a prerequisite for stable monetary development.

Interest is paid for the use of credit. All economic units, and hence also the enterprises, strive not only to utilize credit efficiently, but also to repay it as soon as possible. The enterprises are able to do so only if they comprehensively make their operations more economical and take into account all the factors of raising labor productivity and improving their economic results.

Conclusion

If we summarize the results of our investigation into the questions of the effective influence of the banks, respectively of bank credit, on the behavior of the enterprises in their economic activity, with special attention to the reproduction of capital assets, we come to the following conclusions:

1. Credit significantly influences the actions of enterprises only if they consistently employ cost accounting as an objective economic category of the socialist economy, employ a system of monetary incentives and accountability in a breakdown by employees, observe the proportions of the process of social reproduction and treat credit as an objective economic category.
2. Enterprises resort to credit only when they have exhausted their internal resources, and they strive to repay their credit as soon as possible.
3. Credit significantly contributes toward the development of the enterprises, toward the expanded reproduction of their economic resources, and thereby also toward increasing the economic results of the enterprises.
4. Credit's contribution grows commensurately with the size and effectiveness of the investment projects.
5. By helping to finance investment projects that raise the social productivity of labor, credit significantly influences the favorable development of the currency, i.e., its stability and the rise of its purchasing power.

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POLAND

POLISH ECONOMIC ILLS ANALYZED

Milan IL SOLE-24 ORE in Italian 31 Mar 81 p 3

[Interview with economist Bronislaw Minc, Warsaw University, by Carlo Boffito, place and date not given]

[Text] Among leading Polish economists, Bronislaw Minc is perhaps most outstanding by reason of his enormous experience; he is also the author of a great many books, some of them published in Eastern Europe, in the Soviet Union, and in China. Feltrinelli brought out the Italian version of his "The Political Economy of Socialism" (1967) and of his "New Economic Policy" (1977). Until 1953 Minc headed the coordinating section of the State Planning Committee, and from 1953 to 1968 was director of the Economics Institute at the Polish Academy of Science. Since 1948 he has been a professor at the Warsaw School of Advanced Planning and Statistics.

For all these reasons, we thought it would be a sound idea to interview an economist of his stature and experience, since he could be of great help in explaining the evolution of economic thinking in the socialist countries and in shedding some light on the positions their economists are taking today in the aftermath of the recent crisis in the socialist economy.

[Question] You had a voice in the current debate in Poland on economic reforms; what is your position?

[Answer] I believe that the bureaucratic system of corporate management by the state is hopelessly inefficient; it is, if not the sole cause, certainly one of the prime causes of the present state of affairs.

[Question] In what way?

[Answer] Well, you have only to look at the most obvious aspects of this crisis. The production structure does not match the needs of the people; the quality of production is generally poor; production capacity is not being fully utilized; cooperation among companies is inadequate, and often that lack brings about actual plant shutdowns; it is almost routine to encounter overproduction in several sectors accompanied by a bottleneck, perhaps even a prolonged cutoff in supplies of certain products; the investment level is too high; it takes far

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too long to install new production equipment, and that in turn means excessively long delays in the utilization of large amounts of capital.

[Question] Just what are the basic causes for these difficulties in production?

[Answer] I am going to try to show you, with a little sketchy diagram, the essential factors in the operation of the socialist economic system as it was originally designed and in the revised versions adopted over the past 15 years or so in the socialist countries. In the first column you see the major economic activities: ascertaining the current level of production, establishing the volume and structure of investments and the price structure.

The other two columns identify the agencies which, in the various socialist economic systems, make decisions on production, investments, and prices; such agencies may be monopolies or competitive (assuming that they exist in a socialist economy), and the state. In the traditional socialist economy (see Table 1) it is the state that establishes production, investments, and prices. However, the state may regulate the current level of production in plants only indirectly, through the system of success indices; in actuality, the state does not have either the technical and managerial capacity or the necessary information to act in any other way. In other words, the central authority sets an index which pushes the plant to fulfill the plan and upon which depend both the base pay and the bonuses for the plant managers. So then what happens? By setting both prices and indices the state determines the volume of production, but the companies have a good deal of discretion in tailoring the product mix, and therefore they give priority not to the products people want, or to those necessary for economic growth, but rather to those products which will let them maximize the index to which wages and bonuses are pegged. As a consequence we have on the one hand widespread waste of manpower and of scarce materials, and on the other a perpetually unsatisfied demand: the root cause of the costly and inadequate supply is the bureaucratic system of using indices to control companies.

[Question] Even in Italy we know that in the traditional socialist economic system indices beget distortion in supply; the best known instance is the case of a nail manufacturing plant whose index is the tonnage of its output: that plant will turn out mainly very large nails, thus wasting iron and idling workers whose jobs require small nails. But weren't the economic reforms introduced specifically to correct these flaws?

[Answer] Reforms have invariably promised to replace bureaucratic intervention with economic tools (taxes, flexible prices, interest rates, etc.), but they never did scrap the bureaucratic system of controlling companies through the index, and until you do away with that system you are not going to be able to change anything in any substantial way. Let's go back to the diagram we used for the traditional economic system, and look at Poland. The 1973 economic reform (Table 2) expanded

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TABLE 1 - Traditional Socialist System

	<u>Companies</u>		<u>State</u>
	<u>Monopolies</u>	<u>Non-Monopoly</u>	
Production			X
Investments			X
Prices			X

TABLE 2 - Economic System as Reformed in 1973

	<u>Companies</u>		<u>State</u>
	<u>Monopolies</u>	<u>Non-Monopoly</u>	
Production	X		X
Investments	X		X
Prices	X		X

TABLE 3 - 'Little Economic Reform' of November 1980

	<u>Companies</u>		<u>State</u>
	<u>Monopolies</u>	<u>Non-Monopoly</u>	
Production			X
Investments			X
Prices			X

TABLE 4 - 'Big Economic Reform' now under discussion in Poland

	<u>Companies</u>		<u>State</u>
	<u>Monopolies</u>	<u>Non-Monopoly</u>	
Production			X
Investments	X	X	
Prices			X

TABLE 5 - A Socialist Economic System Without Success Indices

	<u>Companies</u>		<u>State</u>
	<u>Monopolies</u>	<u>Non-Monopoly</u>	
Production	X	X	
Investments			X
Prices		X	X

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the discretionary in-house funds, which meant that companies could decide for themselves on a portion of their investments; they were also granted some leeway in fixing prices. The so-called little reform, introduced in November 1980 (Table 3) took those prerogatives away from the companies, in view of their inflationary nature and, according to the already published official plan, the "big reform" (Table 4) will allow companies to decide upon their investments, but will return the authority to set prices to the state.

[Question] What happens to the indices?

[Answer] According to the 1973 reform the major success index for a company was the value added rate, to which the base pay was pegged on a scale that varied from one sector to another. Under the "little reform," 0.3 percent of any increase in net product will go into the base pay fund, while any decline in net product will come out of it. Under the new big reform the index would be cash flow or profit. These, though, are still annual indices which give companies an incentive to choose a supply structure which does not answer to the needs of the economy, but does, above all, maximize their index, whatever it may be! As a consequence you get distortions in supply and widespread shortages which create cumulative difficulties and hamper the operations of the economy as a whole. Furthermore, the indices, since they are perforce short-lived, put a brake on technical progress and on the introduction of new products: if an innovation will be profitable in the long run but not in the short term -- as is usually the case with innovations -- it will be shunned because it will lower the yearly index. And there you have the reason for the sluggishness of technical progress and for the wretched quality of products endemic in the socialist economy. Even if the company management wanted to do a better job, the system would force them to do a bad one.

[Question] What, in your view, might be a way out of this situation?

[Answer] The solution can be found only in total abolition of the index system. According to the diagram used before (Table 5), setting levels of current production would be left to the monopolistic and non monopolistic companies (assuming we manage to reduce the high level of concentration we have today). To get rid of the supply distortions we must increase companies' independence; to put them in a position where they could afford to take risks and make innovations we must extend their time horizons. The goal of companies must not be maximization of their short-term indices, but satisfaction of demand; and the only way to achieve this is by allowing the companies to seek an optimal profit, by which I mean to optimize their profit over the long term.

[Question] How should investment levels and prices be set, then?

[Answer] Investments should be determined by the state through the banks, which would have to provide scarce financial backing to companies which maximize satisfaction of the people's needs while respecting the principle of long-term profitability. Self-financing should be

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confined to small investments in plant modernization; the central role should be played by investment analysis done by the banking system; the role of interest rates would also be revived. The state should, finally, retain control over prices in the monopoly sector.

[Question] What you would have then would be a system of market socialism in which companies would operate under the discretionary control of the banking system? is that right?

[Answer] I should not like to use the term "market socialism" because in the system I am proposing investments, and hence future production, would be decided upon not by the companies, but by the state through the banking system.

[Question] What about distribution of profits?

[Answer] Wages would be set as they are in the capitalist system, by means of negotiations with the unions. In Poland, wages are made up of two parts: the fixed portion, which is considered income, and the variable portion (pegged to the companies' success index), which is the result of the manipulations I have been talking about. It is better therefore to use the collective bargaining system, which has long been thoroughly tested in the capitalist countries.

[Question] It seems to me, though, that to get your plan adopted you would have to change the role the Party plays in the economy.

[Answer] Of course. Although I don't want to minimize that problem, which is a very big one, elimination of the index presupposes a change in the role of the Party, which now controls all corporate economic activity through the bureaucratic index system.

[Question] The Party would continue to exercise its control through the banking system though, wouldn't it?

[Answer] My proposal consists in adapting capitalist efficiency to the requirements of a socialist society. The nature of the system I propose is socialist in that it is based on state ownership of the means of production: that state control would not be eliminated, but it would be streamlined and made efficient.

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