



ECONOMY AND MILITARY POST SOVIET

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The Soviet economic system came to an end with the collapse of the USSR and the disappearance of communist rule in the final days of 1991. In our view, economic collapse was not the cause of the end of the communist order, although without doubt the economic system was in very serious crisis at the time. An already dysfunctional economy had been disorganised and weakened further by reforms undertaken in the name of *perestroika* by Mikhail Gorbachev and his government. But it was political factors above all that ended communist rule and the USSR and, as has been argued, the economic system could possibly have lived on, albeit in as an ineffective and poorly performing mixed form of economy, combining elements of 'planning' with market forces. In the event, the new government of an independent Russian Federation, led by Yegor Gaidar, embarked on a difficult process of market transformation, at least in the short-term, costly in human terms.

Now, over so many years later, it is instructive to consider just how far this market transformation has progressed. Does Russia now possess a fully functional market economy genuinely comparable with much longer established economies of Western Europe or the United States? Has the socialist economic order that prevailed for some sixty years disappeared entirely, so that it is now receding into memory of interest only to historians? Or has it left survivals and legacies that shape and influence, at least in part, Russia's present-day economy? These issues will be explored in the paper, which draws to some extent on the experience of one particular sector of the economy; a sector that in Soviet times could be considered by some criteria relatively successful. This is the defence industry, or the military economy more generally, which proved able in the USSR to secure nuclear parity with the United States and a conventional capability that throughout most of the post-war years presented a challenge to NATO member countries.

In the Soviet economy from the early 1930s the highest priority sector was the military economy and within that the defence industry, like the rest of Soviet industry entirely state owned. By 1990 it employed over 8 million people, including almost 1.5 million in research and development (R&D). This was over 19 per cent of total industrial employment.

Its output represented 12 per cent of the total output of industry as a whole. But the defence industry also manufactured many civilian goods, in particular those of a relatively high technological level. Indeed, almost all high technology manufacturing in the USSR was undertaken within the defence sector; in 1990 half the industry's total production was of civil goods. In the same year almost 80 per cent of all industrial R&D undertaken in the country was performed by the defence industry and almost 70 per cent of this was for military purposes. Over decades the industry enjoyed top priority in resource allocation, not simply in terms of quantity, but crucially in term of quality, being the recipient of the best available material and equipment inputs and, as the favoured sector, secured with financial resources permitting the payment of relatively high salaries and wages. The attraction, training and retention of skilled personnel, from designers and engineers to machine tool operators, was vital to the industry's relative success and to make this possible the enterprises of the industry were resourced in such a way as to permit the development around them of housing, educational, medical and cultural-sporting facilities of an unusually high standard in Soviet conditions. Notably in the nuclear industry, but also in other ministries, there were special distribution networks making available to employees food products and consumer goods scarce in the normal state shops. There was also a bias to the creation of very large enterprises, sometimes employing tens of thousands of workers, often with a high degree of self-reliance, minimising the possibility of the supply breakdowns so characteristic of the Soviet economy. Some large enterprises even had their own steel works and produced their own specialised production equipment. In this respect the defence industry was not unique. A distinctive feature of the Soviet economy was the extraordinarily low level of sub-contracting. Especially in the engineering industry, enterprises made in-house many components and systems that in a typical market economy would have been supplied by independent, specialised, companies, often small in scale. This is a major reason why in the Soviet economy there were very few small and medium enterprises (SMEs).

Not only were many defence enterprises very large, but quite a few dominated the local economies of entire population centres and in some cases were the centres of so-called 'monotowns', with only a single or very limited number of employers, often located, for security reasons, in remote areas of the country. In the case of the nuclear weapons industry, in particular, some of these towns were 'closed', i.e. they had highly restricted access and their inhabitants had strictly regulated contact with the rest of the country, though they were usually compensated by relatively good housing and pay.

The Soviet economic system was a producer-driven order, with very weak customer power. It was a sellers' market in which even goods of inferior quality found buyers. This state of affairs was also typical of the military economy, even though the customer, the armed forces, was granted some consumer powers not available in other sectors. The defence industry was to a large extent able to determine the types of weapons supplied to the armed forces and their volume. However, the military were involved in establishing the specifications of new armaments and were able to exercise some influence over the quality of their manufacture through a system of so-called 'military representatives' located at enterprises and R&D organisations to monitor their work on behalf of the armed forces customer. But this system had many problems and only in the late Gorbachev years were the military able openly to voice their discontents with this one-sided arms procurement system. Unlike the rest of the economy, however, the defence sector was subject to a form of competitive pressure: for the Party and military leaderships it was considered essential to match the technological innovations of potential adversaries. To this end, efforts were made to provide the defence industry with conditions and incentives that would make this possible, including generous rewards, monetary and non-monetary, for successful scientists, designers and engineers.

Since the beginning of 1991 the Russian economy has been transformed to a very significant degree. The large-scale privatisation campaign of the early to mid-1990s ended the predominance of state ownership in industry, prices were freed to find their own market level and many market-orientated institutions were established. The military economy was not immune from these reforms; indeed, they had a major impact on the defence industry and its performance. Looking at today's Russian economy from the perspective of the theoretical insights of Kornai and Yaremenko, can it be said that market transformation has been fully achieved? Or are there survivals and legacies of the communist past that still shape the economy or exert an influence on current practice? These issues will now be explored, drawing to some extent on the current state of the military economy and its mode of functioning in the new Russia.

Statistics on the overall share of the private sector in the Russian economy is unsatisfactory and contradictory, making it difficult to establish the true situation at present and trends over time. However, the evidence suggests that the state share has actually increased since the late 1990s. Thus, according to the European Bank for Reconstruction and Development, the share of the state sector in GDP increased from 30 per cent in 1997 to 35

per cent in 2010. The 'Expert' ratings agency undertakes an annual review of Russia's largest companies. According to their analysis of the 400 largest companies in the country at the beginning of 2008, the state ownership share amounted to 40–45 per cent.

Taking the defence industry, in 2007 no less than 49 per cent of enterprises and organisations were fully state-owned, 27 per cent had state ownership participation and only 24 per cent were fully private. Given that almost all very large enterprises are fully state owned and private companies tend to be of a smaller scale, the state share of employment and output is probably larger than these figures suggest. Indeed, the available data indicate that 58 per cent of defence industry employees work in the 'state sector', undefined, but apparently meaning at fully state-owned enterprises. While state participation in West European defence industries can be quite substantial, the extent of state predominance in Russia is exceptional. Since about 1997 the state presence has actually increased, partly because a number of private companies have withdrawn from military work and also because there has also been a process of state consolidation, reflecting more general trends in the economy.

In another respect the defence industry retains features of the Soviet past. It remains a sector in which soft budget constraints are still very much present. This raises an issue that has been rather neglected by researchers, namely the extent to which in the Russian economy in general soft budget constraints still have prevalence. Certainly, during the years 1992–1998, prior to the August financial crisis of that year, Russian enterprises exhibited extraordinary ingenuity in maintaining soft budget constraints, resorting to diverse forms of non-monetary transacting, generally summarised as 'barter', which permitted unprofitable enterprises to survive without facing bankruptcy and closure.¹⁵ It is also a surprising feature of the present-day Russian economy that quite a large proportion of enterprises are reported to be loss-making, a proportion that remains high and leads to a suspicion that by various means they are allowed to remain in operation regardless of their lack of financial viability.

A further parallel between the Soviet economic system and that of Russia today is the large scope for the state in redistributing resources. In the USSR administrative control of the domestic economy, plus the ability to shape the nature and volume of foreign trade flows, gave ample possibilities for channelling resources, in non-transparent ways, from profitable, but lower priority, activities to costly, priority, activities, above all enhancing the country's military capability. In the Russian market economy these direct instruments of intervention and control are not available, or only to a limited extent, but substantial rental incomes from the export of hydrocarbons and other resource-based goods again gives large scope for non-

transparent redistribution: the present day Russian state, like its Soviet predecessor, is one that exercises considerable command over resources and this power may well be associated with not dissimilar mentalities characteristic of political leaders in both systems. In such a situation personal rent seeking and appropriation are unlikely to be absent.

One structural determinant of the Soviet past is still present, but in a much weaker form. This concerns the 'structural militarisation' identified by Shlykov. The system of mobilisation preparation in the event of war or other major national emergency still exists, and is still shrouded in secrecy, but on a more modest scale. The limited evidence available suggests that mobilisation reserves are now mainly restricted to the defence industry and that the reserves maintained are on a smaller scale than in the USSR and therefore have less impact on the rest of the economy. However, while there is an annual federal budget allocation to fund the mobilisation system, it appears that many defence industry enterprises incur costs in keeping mobilisation capacities, costs which are charged to overheads.

In the Soviet economy long-term plans were considered important and much time and effort were mobilised in order to elaborate them. Not only was there a five-year plan, but also 'perspective' ten-year, and even twenty-year, planning documents and programmes. Yet, paradoxically, Soviet enterprises and the system of economic management in general worked in reality to very short-term time horizons. As Kornai has argued persuasively, day-to-day economic management often amounted to 'putting out fires', resolving one crisis after another.³⁸ The commitment to long-term perspectives clearly had ideological significance for the Communist Party, conveying a sense of control and purpose to the population and the outside world, but it may also have provided some sense of security to the ruling elite. The situation in Russia is not dissimilar. Faced with the spontaneity and unpredictability of a market economy in a globalised world, the Russian government has a considerable commitment to preparing long-term programmes and strategic documents for almost all aspects of life, from national programmes of socio-economic development, as the current one to 2020, to regional equivalents, to ten-year state programmes for armaments, energy, transport, innovation, science and technology, etc. There is also much talk of the need for 'strategic planning' and this has become an increasingly central concern under Putin's leadership.³⁹ This commitment may represent in part inertia of thought from Soviet times, perhaps even some nostalgia for the apparent certainties of the past, but may also reflect a need, in new conditions, for reassurance and security for those in power. And today, when

serious problems arise, the top leadership also engages in a form of 'fire fighting', resort to what has become known in Russia as 'hand control', with personal intervention at the enterprise level and the immediate issuing of orders to relevant government agencies.

This paper has explored the extent to which the present-day Russian economy still possesses features inherited from the socialist economic system of the USSR, with a focus on the military sector, which has remained the least changed by overall market transformation. But, as argued, in some other respects the Soviet legacy lives on in the new post-communist order. This is not surprising. The socialist 'planned' economy existed for over sixty years and became profoundly institutionalised and those today in leading positions of power in Russia are products of that system and to some extent bearers of mentalities associated with it. Amongst economists there has been much discussion of whether market transition has been completed in the ex-communist countries. While there is a good case that it has been in some countries of Eastern Europe, now established members of the European Union, it is more debatable with respect to Russia and other member countries of the Commonwealth of Independent States. For Russia, the undisputed principal actor of the military economy of the former Warsaw Treaty Organisation, the phenomenon of protracted transformation is the least unexpected. A strong case of path dependency is not being asserted, rather a matter of political-economic institutional inertia.

A final consideration arises from the fact that it is now twenty years since the collapse of Soviet communism and during that time there have been many significant changes in the wider world. The process of globalisation has gathered pace and major new actors have emerged in the world economy, challenging the dominant powers of the post Second World War settlement. More recently, there has been a severe global financial-economic crisis which, at the time of writing, has not fully run its course. These processes have led to changes in the market model itself, making more problematic the criteria by which the present-day Russian economy should be assessed. It has become evident that soft budget constraints are not a phenomenon of the Socialist economic system alone, but can exist in the most developed market economies, where companies considered 'too big to fail' can be subject to budget support by governments, even by those with a strong ideological commitment to free markets.⁴⁰ Perhaps, after all, notwithstanding the reservations outlined in this paper, Russia is now much nearer to becoming a 'normal' market economy.

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