CHAPTER IV

Price Reforms
Since the heart of the market economy is the coordination of economic decision via the price mechanism and one of the main problems of the planned economy was distorted prices, price liberalization is fundamental to the transition to the market economy. There was little disagreement among reformers on the importance of price liberalization. However, whether the liberalization should be decreed all at once through shock therapy or be phased in more gradually remained a controversial question throughout the perestroika days.

Price liberalization provoked at least two main worries. The first was how prices would behave in the absence of a properly competitive environment. The other concern was that price liberalization would set off inflation. In this connection a fundamental question before the reformers was - whether the price liberalization should be carried out before or after enacting measures to increase domestic competition. A related question was whether competition should be festered primarily by exposing the economy to foreign competition or by encouraging the emergence of new domestic agents through private capital formation, demonopo-
This chapter which consists of three parts, gives an account of the existing price structure on the eve of perestroika and the objectives of the price reforms, in the first part, the proposed reform outline is discussed in the second part of the chapter, while the strategy of the reform, the complications of restructuring prices, are subsequently followed by the reform debates of the perestroika era in the last part.

I

Price structure on the eve of perestroika:

A clearly detectable imbalance was evident between prices of manufactured, agriculture, and consumer goods, and also within each price group. Thus the overall structure of wholesale prices corresponded neither to current trends in economic development, nor to the cost structure of production. In developed industrial countries prices of manufactured products are typically low in relation to prices paid for raw materials. But opposite picture emerged in respect to the then wholesale prices in the Soviet Union. Artifi-
cially low prices for raw materials created economic barriers that impede reliance on intensive production methods, limit the wide dissemination of resource saving technologies, and hamper comprehensive utilization of raw materials.

At the same time prices for products of machine building sector were generally set in accordance with an average of actual cost in each branch practically ignoring the actual effectiveness of machine tools and related equipments in the economy. Numerous and rather substantial surcharges on wholesale prices, which had raised the overall price level in machine building had not proven to be an effective stimulus for rapid renovation of productive capacity, or for the creation and mass assimilation of highly effective types of new equipment. The main problem here was that the equipment which had long been fully assimilated, or even become outmoded, continued to be profitable to operate and contribute to the formation of sizable economic incentive funds. Relative retail prices among certain food products, and between food products and manufactured goods, had become

1. For details see, Nikolay Ya. Patrakov, Prospects for Change in the system of Price Formation, Finance and Credit, Soviet Economy, 1987, 3,2, pp. 135-144 (Eds).
substantially distorted. Retail price policy clearly did not provide enough flexibility to reflect the changing needs of the population.

**Importance of change in the price structure:**

The increased importance of prices in the perestroika of the economic planning system shows up primarily in two areas. First, the planned system of prices should play an role in the reconciliation of physical and value flows. The value of material resources, goods, and services circulating in the economy and also delivered to the ultimate consumer should correspond to the amount of money (both cash and financial balances) at the disposal of economic organizations and the population for the acquisition of products and services in the market. Such balance must be preserved at the aggregate level as well as within each commodity group. In consequence, the social demand for resources and products arising from the proportions fixed in the plan will emerge as effective (money - backed) demand and price relationships will reflect the balance between that demand and production volumes emerging from the process of plan formations. If you
have equality of supply and demand and price levels correspond to the full economic costs of expanded reproduction, then that will also mean that represent socially necessary expenditures.

Second the planned price system performs the important role of reconciling national economic and individual enterprise interests. This function follows from the two normative functions of price. First, prices, as economic normative determined directly by the plan, must preclude (make unprofitable or economically disadvantageous) socially unjustifiable expenditure for production. Second, price should provide a profit sufficient for the further development of production at planned rates of growth, and the formation of material incentive funds according to plan normative such price structure creates a genuine economic base for the conversion of enterprises and association to Samoukopayemost and Samofimahsirovaniya (self-financing).

Therefore, price is destined to play an exceptionally important role in a comprehensive system of management of a socialist economy. It is the role to become the connecting link between the system of centralized planning and the
financially accountable economic activity within individual economic units. That guarantees the commensurability of costs and results in the economy as a whole, and the coordination of economic interests in the achievement of maximum economic efficiency of social production.

With these requirements as a point of departure, the fundamental task of price reform in that new environment can be formulated in the following manner:

One, Industrial wholesale prices should reflect the socially essential level of expenditures for the reproduction of output in proportions defined by the national economic plan; they should provide for a balance of planned economy in all sectors of social production, and they should create an economic incentive to produce high efficiency new technology that guaranteed real resource savings to users and a lowering of aggregate costs per unit of value.

Two, agricultural procurement prices should equalize the economic environment of collective and state farms located in different natural and climatic zones so that the produces of agricultural enterprises will depend primarily
on the effort of labour and on the level at which production is organized in each collective. Also, procurement prices should encourage an optimal specialization of agricultural production in order to obtain the necessary quantity and variety of agricultural products at the lowest total cost.

Three: Retail prices should play an active role in the distribution of goods in accordance with the quantity and quality of labour, in achieving a dynamic balance between effective demand and the supply of goods and services.

II

STRATEGIES FOR CHANGE:

The reformers also aimed at a complete overhaul of pricing structure. The reform outline envisaged the radical reform of prices and price formation within 3-5 years of the introduction of perestroika. It was made clear that the prices were to reflect supply and demand and that the proper relationship among wholesale prices, retail prices, wage rates and between raw material and manufactured products, were to be established. All subsidies were to be eliminated. For sufficiently decentralizing the system of price forma-
tion, a three-tier system was to be developed: centrally fixed prices, negotiated contract prices allowed to fluctuate within limits (say within about 30 percent) and freely fluctuating contract prices. The share of centrally fixed prices was to be substantially reduced covering only the most essential goods - capital goods, raw materials, and consumer goods.  

A radical reform of the price system in the Soviet type economics is not an easy task not only because of the anomalies in existing price systems but also because it has serious social and political implications. In case of the Soviet Union reformers did not have correct and adequate information on the nature of prices nor was there any agreement on the approaches to the reform required or on the role of prices in the economy. While some Soviet economists argued that if irrationality in the price system was to be removed and if there was to be an end to wasteful and huge

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subsidies, the prices must be revised upward, others vehemently opposed it and advocated a downward revision. Some argued for phased revision, beginning with wholesale price. Most of them resorted to populist arguments saying that price changes should not result in a fall of living standards. Neither there was clear idea on the nature and extent of state control over price formation under the proposed reform. The Chairman of the Soviet price commission gave the impression that strict state requestion of prices will remain over vast areas even after the reform. Enterprises would be given the freedom to fix prices only within narrow limits. Meanwhile, ordinary people in the Soviet Union were apprehensive of price reforms, and fearing that price would hurt them as in Poland, opposed such reform. Given these disagreements, confusion, and controversies, the process of price reform was found to be painful and prolonged affair. Thus, required price changes could not take place within the expected time frame.

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This has also been so because price reform was a very complicated and sensitive topic in the Soviet Union and together with agriculture, was one of the hardest political question Mr. Gorbachev had to face. Despite the problems and potential political pitfalls, it was essential for the success of the economic reform programme. Political aspects of the reform had been very important. It appeared that the majority of senior party officials were opposed in principle to the freeing of prices, seeing this as a dangerous step towards market economy and capitalism. High inflation, falling living standards and possible civil unrests were also considerations which worried a number of politicians. 4 As discussed earlier, most of Mr. Gorbachev's economists and advisors saw free pricing as a necessary economic indicator of production costs: a price reform including the end of many state subsidies is the only way to make the economic reform succeed, they argued. 'It is apparent that the price system must be replaced, the question now is not one of partial or another adjustment of some or other prices and rates, but of a radical reform of the entire price system'.

4. Ibid
According to Abel Aganbegyan, one of the main purpose of the reform was to change the centralized methods of running the economy and bring production into line with consumption needs. To do this, organizational, economic and social conditions had to be changed. A radical reform of management at enterprise level needed to make them self financing. 5

As early as in the late 1988, Aganbegyan said the main cause for concern over any proposed price reform was the possibility of inflation. There were too few goods in the shop and he said it would be 'unwise' to introduce a full scale retail price reform without thinking through the implications for the economy and the population as a whole.

Under the new system enterprises were to receive development control figures from the centre once every five years. These dates would contain list of requirements which the state expected the enterprises to fulfill on production, economic, scientific and technical and social development.

Those figures were to be instructions, and not recommendations. The enterprises would then plan their own work on the basis of those figures. The state on its part would place orders which would be compulsory, in the first few years of transition, as the economy switched from planned to decentralized management, the proportion of state orders were to amount to 50-60 percent. More realistically, state orders would probably account for 80-90 percent of production for at least two to three years. In theory, when price reform has been carried out, the credit and finance system restructured and wholesale trade introduced, the proportion of state orders would be reduced, under perestroika time table, by 1990 state orders should have accounted for 25-30 percent of production.

The new system also took into consideration the adverse effect of free pricing and proposed two principles. First, prices rises must be implemented in a democratic way and publicly. There was even a suggestion that a referendum should be held. Second, before the state could raise consumer prices, particularly for basic foodstuffs, a system needed to be introduced which could ensure that such rises
did not adversely affect those on lower incomes.

According to official statement, new industrial wholesale prices, were to be introduced on January 1, 1990. The calculation of costs for the new prices would include higher social insurance rates, additional changes for the use of water, greater rental payment in extractive branches, and changes for environmental protection measures. However, no fundamental changes were indicated in the principles for pricing new products of the raw material branches and new machinery, equipment, and instruments.

On the whole, the changes envisioned in industrial procedure prices correspond more to a "revision" than to "reform". In Soviet pricing terminology a reform (reforma) refers to a basic changes in the way pieces are constructed, whereas a revision (peresmotr) adjust may prices without altering the fundamental scheme for price formation.

DEBATE OVER IDEAL REFORM PACKAGE:

Most Soviet socialist were convinced about the necessity of a price reform if the economy was to make a transition
to market principles of pricing. The growing debate however,
focused on the issue of the kind of the reform to be imple-
mented. Meanwhile, one could get the impression that neither
planning agencies, government departments, nor economists
had a very clear idea about the realistic methods of accom-
plishing it. Two divergent views put forth by Nikolai P.
Shmelev and Morris Bernstein caught most of the attention of
the reformers over this complicated issue.

Nikolai P. Shmelev\textsuperscript{6} stressed that an ideal reform
would address two objectives and would have to be implement-
ed in two stages. The first goal and first stage would
involve smoothing basic price proportions, i.e. between
wholesale, purchase (Zakupochnyye), and retail prices. The
second goal and second stage would consist of minimizing
centralized intervention in pricing functions to the market,
i.e. to the relation between effective demand and the sup-
ply.

\textsuperscript{6} For details see in the \textit{Soviet Economy Roundtables on the
19th Conference of the CPSU} (The 19th, 1988, pp. 123-127;
The Aftermath 1988, pp. 196, 200-202, 204-205) [Eds].
"The first goal and first stage of the price reform are the most important at present: establishing in prices objective proportions that correspond to basic world proportions. One of the most serious consequences of the administrative command system has been the arbitrary deformation of virtually all basic price relations in the economy. As in consequences, prices of raw materials, fuel, food, transportation, housing and perhaps most important manpower have been depressed artificially at the same time that prices for machines, equipment, and an entire range of industrially produced consumer goods were deliberately elevated. At the present time it is not uncommon for Soviet prices to very (above or below) world levels by a factor of 3 or more up to now this has been the most important obstacle to the economy's transition to intensive and balanced development. So, first approach in reforming price structure should involve elimination of the glaring distortion in price — otherwise it would be tantamount to be living in an economically unreal world.

Second, state price subsidies must be eliminated, at the same time that the turnover tax is removed as a source of budget revenue. The resulting losses to individuals from
liquidation of price subsidies will be offset almost entirely by elimination of the constant overpayment for goods subject to the turnover tax. Today the amounts involved in state subsidies to the consumer and turnover tax revenues in the state budget are almost equal. Why must this money be shifted from one pocket to the other? Both phenomena are abnormal and non-economic and if a normal economy is the objective, then this grievous legacy of the past must be abandoned.

Shmelev also gave an alternative version. He based that on three main premises: First, that price reform was necessary and inevitable; Second, that it should not be an isolated act, but a gradual and rather slow process which must begin with wholesale prices and end with retail; Third, that the reform of retail prices must be timed to coincide with the saturation of the consumer goods market as the signs of that saturation become obvious.

Shmelev endorsed increases in prices for fuels and raw materials and decreases in prices for machinery and equip-
ment. He considers these changes desirable to reduce differences across branches in average profitability, and to create conditions for "partial convertibility" of the ruble. But Shmelev did not explain how the price changes he favoured would contribute to what kind of even limited convertibility of rouble. For instance, he did not address the relationship of domestic prices for exports and imports to their foreign prices—either through official exchange rates or differentiated currency coefficients.8

A completely different view was held by Morris Bornstein of the University of Midrigan. He called the planned changes expected to take place in wholesale pricing on 1 January 1990, as a revision rather than a reform of pricing. He also believed that the greater use of contract prices was not likely to provide much of an improvement in the pricing of producers goods and would apply to the relatively small


8. For detailed discussions on exchange rates, and relationship of domestic prices for exports and imports to their foreign prices, see Doronin, Igor., "Monetary Instruments : Problems of Their Improvement", Foreign Trade, 69, 4: 33-36 April, 1988 a. 156
share of output on which prices were not set by state pricing agencies.

Other advocates of reform in state retail pricing proposed an increase in retail price toward market clearing levels equating demand and supply. The closer prices approaches these levels, the more nearly would be achieved the goal of "equality of all roubles" in purchasing power across goods, across regions, and across households.\(^9\)

Under this provision, different segments of the population would receive different degrees of "compensation" for such price increases, through changes in wages and transfer payments. Thus Kazakenich, suggested such a retail price reform as to be coordinated with a reform of wages, announced in 1986, and to be gradually implemented over several years, and a corresponding pension reform.\(^{10}\) This view


was also supported and recommended by Gladkiy; Bim and Shokhin.11

In case of savings, another distinguished Soviet Econo-
mist Stanislav S. Shatalin, proposed that no similar com-
pensation for retail price increases would be provided for
savings (in cash holdings and saving bank accounts) and
their purchasing power would be decreased accordingly.12
Such results were considered desirable and deemed better
achieved by price increases than by a monetary reform in-
volving the exchange of each present rouble for less than
one new rouble.

Increases in state retail food prices, through a reduc-
tion in subsidies separating them from agricultural purchase
prices, were proposed for several reasons. The primarily one
being to reduce the excess demand. In addition a revision of
state retail food prices could include adjustment of rela-
tive prices within food groups for substitutes.

11. Cited by Bornstein Morris, "Price Policies and Comment
on Shmelev", Soviet Economy, 1987 3,2, pp. 130.

12. Shatalin Stanislav S., "Sotsial roye razvitiye ekonom-
cheskiy rost (Social Development and Economic Growth)",
Kommunist, 1986, p. 66.
Heavy subsidies on the prices of some related consumer goods were criticized by Economists led by Pavlov and they pointed out the burden of subsidies on the budget on the one hand, and shortages at artificially low prices, on the other. The remedy proposed was an increase in state retail prices, accompanied by "compensation" to the population through concurrent increases in wages and transfer payments - "before the start of the next five year plan" in 1991.¹³

According to Shmelev, an ideal scenario was similar to the official vision, combining higher prices to reduce excess demand with "compensation" payments, at least for low income people. A reduction in subsidies for food products would also be offset by a cut in turnover taxes on domestically produced manufactured consumer goods.¹⁴

Shmelev endorsed "compensation" to (at least part of) the population for retail price increases without analy-

13. Pavlov, V., "Vazhnaya Sotsavnaya chast' Perestroyki (An Important Component of Restructuring)", Kommunist, 64, 1987, p. 24-26, Official Version was also similar.

sing and evaluating proposed compensation schemes. They generally involved to approaches (1) offsetting increases in food prices by reduction in prices of non food consumer goods, and (2) increases in money income (Pakhomovskiy, 1987; Chekhlov, 1988; Lopatnikov, 1988).

The problem with first approach was to identify the appropriate goods they should have been goods for which the price cuts could come out of turnover tax revenues, in order to satisfy the principle that prices should cover costs (and provide "normal" profits) for production and distribution. Also, there should be goods for which supplies were ample to meet greater demand at lower prices, in order to satisfy the principle that prices should clear the market.

In the second approach, if the increment to household money incomes were as large as the increase in the value of retail sales resulting from the price increases, there may be no reduction in the excess aggregate demand of households. Whatever the amount of such compensation payment, 15. Some of the increase in household income from compensation payments might be saved voluntarily.

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their distribution across households must be decided. Presumably the compensation payment should be made to households as consuming units, rather than to individuals as workers. A differentiated scale could provide larger payments per person to household with lower per capita incomes, in an effort to reduce income inequality per capita across households. But such payments would alter the income differentials (from differences in wages by occupation, skill level, and productivity) envisioned by the wage reform (Gladkiy, 1986).

These problems were recognised by some Soviet economists who question the advisability of "compensation" through (1) reduction in prices of non food consumer goods or (2) payments to households (Deryabin, 1988. Other Soviet economists consider compensation payments economically undesirable but perhaps politically necessary if retail

Tseny i dokhody (Prices and Incomes), "Trud, July 14, 1988, p. 2.
prices are to be raised.17

Finally some economists share Shmelev's view that retail price increases are so politically sensitive that they threaten Perestroika as a whole. According to Academician Shatalin: "The new economic mechanism has not yet been formed. and under the present conditions it is a naive and dangerous understanding to pull it by such a thin and sensitive thread as retail prices.18

**Conclusion**

The disarray in Soviet thinking on how to address the issue of prices was striking. In the past the USSR had revised wholesale prices at long intervals to reflect accumulated changes in relative average production costs. Another revision of this kind was planned for 1990-91 as part of the 1987 economic reform package, but had not been imple- 


18. "Khochu prizenat' svoyu oshibku (I Want to Acknowledge My Own Mistake)", Sotsialisticheskaya industriya, October 30, 1988, p. 2.
mented till then. The mechanism of price formation remained basically exchanged except for the limited flexibility introduced in 1988 and 1989. Ryzhkov's December, 1989 programme promised a revision of industrial, wholesale prices and agricultural procurement prices in 1991 but postponed a revision of retail prices till 1992 - and then only after nationwide discussion. In May 1990 Ryzhkov proposed that the schedule be accelerated - that "at the beginning of 1991, a simultaneous and comprehensive review of the entire price system should be implemented in a centralized manner". 19. The ensuing outcry in the Supreme Soviet and in the country regarding the magnitude of the proposed retail price increases illustrated just how divisive the question of price realignment had become. The government was in a bind - industrial wholesale prices for energy and basic materials were too low, and the government wanted to increase prices for agricultural products but it could not raise energy and material prices without reducing the profits of other enterprises, and raising farm prices without adjusting retail

prices resulted in larger budget deficit and greater macroeconomic disequilibrium. Thus the concept of the need for a comprehensive revision was a sound one.

Much of the argument over price policy centers on the degree of control to be exercised over price changes and their timing. The May 1990 programme identifies three basic types of prices: (1) prices established by the state, (2) regulated prices which could vary within certain limits from the official price list and (3) free or flexible prices. Ryzhkov indicated that in view of the strained marked situation the state should establish prices for important raw materials, fuel and power, the output of monopolies, and prices on compulsory sales by farms to state procurement agencies. Furthermore the state would retain control over retail prices for most consumer goods and charges for electricity and transportation. He estimated that in 1991, as much as 55 percent of retail trade turnover would be conducted at state fixed prices, 30 percent at regulated prices, and 10 to 15 percent at free prices. Then, "as market relations are established and the market is filled, the proportion of prices being controlled by the state will gradually be reduced and free prices formation will expand".
The arguments for a phased transition to market-determined prices appear to be persuasive. First, there are the likely problems inherent in an "all-at-once" approach when relative prices are so distorted. Free prices would result in quite substantial price changes that would be blamed on the reliance on markets rather than viewed as a necessary and overdue measure, even in a planned economy. As Joseph Berliner contends it would be better to take this medicine in pre-transition stage. With justification, the government also maintained that predicting the impact on living standards will be much easier in a price revision than in a market price regime. Thus the compensation that the government had promised could be calculated and introduced simultaneously or in advance of the price revisions. The overall rational for revising wholesale and retail prices in the early stages of the economic reform process was to reduce the possibility that the income output and employment adjustment that would occur after controls over prices and output are removed would be so large that they would destroy the reform.