Revitalizing the Russian food system:

Photo: Roy Rauschkolb

The difficult and protracted economic changes now underway in eastern Europe and the former Soviet Union provide several compelling lessons for economic policy. One of the most important lessons concerns the dangerous simplicity of "privatization." Nowhere does this naïve policy prescription hold such potential for long-run harm as in Russian agriculture.

Markets in theory and practice

by Daniel W. Bromley

The dominant theme in the transition to a market economy in Russia and elsewhere in eastern Europe is that of "privatization." The faith in privatization is particularly strong for decollectivization of agriculture into individual ownership units based on family farms. While one can understand the political and emotional importance of decollectivization, I suggest that it would be a serious mistake to suppose that immediate and complete decollectivization of Russian agriculture is either necessary or sufficient to reinvigorate the Russian food system. Indeed, the evidence suggests that it will take massive and sustained financial assistance to make the emerging peasant farms viable even as subsistence units, let alone as the backbone of a revitalized Russian food system.

Rather, progress in Russian food security will come by leaving the "ownership" question aside while devolving management decisions to individuals as members of cooperatives (in *kolkhozes*), or as employees (in *sovkhozes*). Evidence suggests that it is mainly urbanites who advocate decollectivization (for their own access to a rural parcel), while most Russian farmers favor retention of the larger structures. While individual collective farmers can leave and establish their own farms, only the worst land is being made available for such enterprises. Financial disaster looms on the horizon if these marginal units are allowed to become a drain on the Russian treasury.

In short, splitting large operations into family units under the banner of "privatization" will unnecessarily disrupt the production sphere. Equally important, these new units would face the serious problem of the shortage—and indivisibility—of most agricultural machinery.

Moreover, human capital in Soviet agriculture was highly specialized in particular tasks. If there is one reality of farming it is that the owner-operator must understand a wide array of technical processes and tasks and be able to carry them out quickly and with considerable skill. Welding, machine repair, general veterinary services, market prognosis, weather forecasting, time management, accounting, plant disease monitoring, and pest management come immediately to mind. To imagine that individual collective farmers stand ready to assume the full and complex portfolio of independent and often-isolated farm managers is to imagine the impossible.

Widespread decollectivization also would fly in the face of trends in agricultural consolidation so prevalent in North America and Europe. Over 50 percent of the planted area in Russia is devoted to grains produced on large holdings. At the current time, Russian wheat yields lag those in Canada by a mere 10 percent. In spite of years of propaganda about the "inefficient" Soviet farm, it is well to pause and contemplate the long-run benefits of dissolving—in the name of productivity enhancement—Russian

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wheat farms that are within 10 percent of production levels now obtained in Canada. This is not to deny the opportunity for productivity gains in other sectors of agriculture, but those gains will come through gradual structural adjustment as off-farm market opportunities continue to evolve.

With improved markets for inputs and outputs, there is little evidence that continued joint management of most large Russian farms will seriously undermine efforts to improve the Russian food and fiber system. Recall that agricultural tenancy in North America and western Europe is not insignificant, and yet productivity levels under these circumstances are rarely denied—or even discussed. There is little reason to suppose that joint management with various long-term leasing arrangements for land will not also work well for the bulk of Russian agriculture. The key economic issue is not that of nominal "ownership." Rather, the pertinent issue is the institutional arrangements that define the incentives under which production is to be undertaken.

There is evidence that some Russian experts grasp this important point. A recent account of Russian agricultural experts visiting the United States (*The New York Times,* July 3, 1993) notes that the deputy director of the Nizhny Novgorod Department of Agriculture believes that "Russia should struggle less over questions of who owns enterprises and more on how to force them to compete" (p. 23). Indeed.

The quickest and most cost-effective strategy to revitalize the Russian food and fiber system is to promote the development of competitive markets for inputs, and for farm products. This too is "privatization" but it is focused on marketing channels rather than on land and other capital assets in the production sphere. Input supply problems in Russia are legendary, as are product marketing problems. Indeed, it is estimated that one-half of the potato crop in the Moscow region was habitually lost because of harvesting and storage problems. In a word, the marketing channels in Russia are far more deficient than is the production sphere. Competitive markets in input supplies and product markets would provide the very incentives needed to induce improved production on Russia's existing large farms. These product markets would solve the chronic failures in the movement of goods from farms to consumers.

It is easy to forget our own historical experience in agriculture—a history dominated by concern for the competitiveness of input and product markets. Recall the preoccupation with farm credit, with marketing cooperatives, with supply cooperatives, and with price parity. These concerns were driven by the recognition among both farmers and politicians that what really matters in a market economy is the incentives faced by those who work the land.

The *New York Times* article continues by noting that a particular farm undergoing privatization continues to flounder. Because of a lack of "networks of private suppliers and product processors, it remains a cog in a Government-run agricultural apparatus that routinely loses to spoilage 20 percent or more of the output of various sectors" (p. 23). Deconstructing the production sphere of Russian agriculture to create "family farms" would simply divert necessary attention, technical assistance, and financial resources away from the more important need to create competitive markets for agricultural inputs and outputs. Russian farmers do not need to be taught how to produce food and fiber. Rather, they need competitive markets for the inputs they must buy, and for the products they bring forth.

Much is made of the legendary inefficiency of Soviet farms. Who has not heard of bread being fed to livestock because it was cheaper (after the subsidies) than grain? But is this problem rooted in the ownership structure of Soviet farms, or does it arise from perverse prices in the marketing and processing spheres? Russian farmers were simply acting rationally, given the relative prices they faced. The deconstruction of Russian farms will not address this matter. The problem can only be solved by reforming price policy beyond the farm gate.

A second aspect of the alleged "inefficiency" of Soviet agriculture arises from national budgetary practices in which joint costs were not properly allocated to their real purpose. Budgetary allocations to "agriculture" went to state and collective farms which were, in reality, multiproduct firms. These "farms" represented the only effective presence of the Soviet state at the local level. In practice, these collective and state farms were responsible for local schooling, transportation, communications, primary medical care, housing, and other local public goods. The financial picture for agriculture would have looked different under proper cost allocation procedures. Of greater importance for the future, one must worry about how these local services will be provided once the rural community is individualized under the banner of "privatization."

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Institutions and markets

This discussion raises the fundamental issue of the institutional foundations of capitalism—or of markets. Institutions are often regarded as laws and regulatory decisions that serve only to constrain the otherwise efficient workings of a fictional "free market." A market economy cannot function, however, without working rules that serve to reduce the costs of information about potential transactions. Additionally, institutional arrangements serve to (1) reduce the costs of negotiating bargains; and (2) reduce the costs of enforcing those transactions that have been negotiated. A contract is an institutional arrangement that implies specific performance on the part of both parties. If one party to a contract fails to comply with its terms, the legal system provides relief. When contracts are difficult to arrange, and when the legal system fails to provide effective enforcement, then the promises of a market economy are dissipated in what we call "transaction costs." The law of contracts, an essential economic institution, serves to facilitate market transactions. Other institutions concern legal rules on property ownership, credit, and bankruptcy. These economic institutions must be in place before a market economy can emerge.

But the emergence of markets also requires a prior social legitimacy. This means that there must first be decisions concerning whose interests are to count, and how these interests will be articulated through the political system. In a word, an effective (efficient) market cannot exist until there is a coherent political entity that establishes the legal foundations of markets. Additionally, that political entity must stand ready to enforce rules of possession (called property rights), and rules of transactions. This necessary political entity is a nation-state. Many of the problems arising from economic "shock therapy" in Russia are testimony to this truth. That is, Russia may indeed be a "nation" but it is not yet a coherent state.

Public policy and its correlated institutional arrangements—the "working rules"—frame and define individual domains of economic choice. Law, the empirical manifestation of a structured civil society, provides the guidelines for economic behavior. This explains why the United States Supreme Court stands as the single most important actor in the constantly evolving definition of American capitalism.

A market economy requires a coherent legal system that indicates (1) clear lines of authority and the division of responsibility among governmental units; (2) clarity and precision in legal rules; (3) mechanisms and processes for the protection of property rights; (4) procedures that offer stability and predictability; (5) a sense of fairness focused on law as process more than outcome; and (6) accessibility of laws and regulations to the public.

It is through the design and establishment of these institutional arrangements that societies create markets. Indeed, markets can only exist within a legal system that has consciously set out to create ordered domains of exchange. Markets are arenas of information about the terms of trade, about future expectations, and about future control over income streams. The essence of the legal foundations of an economy is to provide a predictable structure within which that exchange can flourish.

The central problem for the nations of the former Soviet Union is to create a meaningful state and the associated institutional arrangements that will channel self-interest into socially useful directions. This requires more than having the former Soviet government "get out of the way." It requires a new and prominent role for government as an agent of the political entity we call the nation-state. Without that, one has anarchy in which aggressive individuals can become very rich by selling what they most probably do not own. The evidence suggests that this is precisely the situation in Russia today.

In a centrally planned economy, these economic institutions consist of input quotas, production plans, accounting prices, shipping schedules, the supply of dwellings, the availability of jobs, and the like. In a market economy, these economic institutions consist of a different constellation of constraints and opportunities—tax laws, wage rates, contractual obligations for workers, product liability for commodities, health insurance premiums and coverage, and the working conditions in factories, farms, and mines.

The economic institutions in Russia and the other nations of the former Soviet Union were characterized by the **presumption of prohibition**; if an economic action was not written down as acceptable, it was prohibited. The presumption of prohibition stifled all manner of otherwise useful economic activity. On the contrary, a viable market economy requires institutions (working rules) predicated on a presumption of permission in which an economic action, if not expressly forbidden, is permitted.

This profound shift in the burden of proof and liability for economic action stands as the basic issue in the creation of a vibrant economy. While a market system is based upon a presumption of permission, that market must still be embedded in a social fabric that sets general parameters for acceptable commercial behavior. This illustrates the inevitable interplay between the political sphere and the economic sphere.

Photo: Roy Rauschkolb

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Evidence to date suggests that the naive and simplistic acceptance of the notion of the "magic of the market" has beguiled the Russians into the pernicious idea that a market economy is one without laws. They seem to imagine that *laissez faire* translates into "anything goes." On this tack, yet more chaos is practically assured.

Of course no economic system can thrive if locked into a rigid structure that does not recognize the exigencies of new technology, new scarcities, or new preferences on the part of buyers. Indeed, this flexibility represents one of the main benefits of market processes as opposed to command processes. It is, however, a mistake to attribute this flexibility to the existence of markets. Flexibility arises from a political and legal environment that recognizes new opportunities, and that functions to create opportunities for individuals to capitalize on those opportunities. Markets do not *cause* adaptation to new conditions. Rather, markets *allow* responses to those situations as permitted by the political and legal foundations of the economy.

The lessons of American economic growth are dominated by the instrumental use of the law to encourage enterprise—whether the land acts, the creation of new mining law, or the development of a new water law to fit the ecological and economic conditions in the arid western part of the nation.

Conclusions

The essential problem of economic policy is to create exchange opportunities—and hence relative prices—that will guide self-interested agents to act in the interest of the larger community. The sum of individual actions will thereby be larger than the mere sum of their parts—a point popularized in the 18th century by the moral philosopher Adam Smith. Markets are signalling mechanisms, but markets cannot function without institutional arrangements of one form or another. Markets, if they are to represent legitimate signalling, must function so as to hold down (1) the costs of obtaining information about possible market opportunities; (2) the costs of negotiating contracts or bargains among market participants; and (3) the costs of enforcing bargains or contracts that have been struck.

The successful transition to a market economy in eastern Europe and the former Soviet Union requires that attention be devoted to the institutional underpinnings of emerging markets. Exclusive focus on the usual macroeconomic factors—exchange rates, savings, investment, trade balances, domestic and foreign debt—detracts attention from the fundamental preconditions of a market economy. These necessary preconditions are a coherent nation-state, and economic institutions that encourage exchange at low transaction costs. The naive promise of privatization and decollectivization of agriculture, without careful thought given to the accompanying institutional changes beyond the farm gate, will retard rather than revitalize the Russian economy. ■

■ For more information

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