Food Shortages in the Former USSR

Mainly the Result of Monetary Imbalances

by William M. Liefert

➢ **Wage, price, and monetary policies during the Gorbachev years have been most responsible for the food crisis in the republics of the former USSR, not problems in agricultural production. These non-agricultural policies distorted demand, weakened the distribution system, and created inflationary macroeconomic imbalance. In 1991, though, these conditions finally began to affect the supply side of the economy, causing output, not only in agriculture but across sectors, to fall. The main short-run objective of the ambitious reform program begun by the Russian Republic in January 1992 is to restore macroeconomic balance and thereby eliminate the inflationary pres-**

The main cause of the growing food shortages in the former USSR has been wage, price, and monetary policies that affect demand and distribution. From 1985 through 1991 Soviet per capita money income rose by about 150 percent, while productivity increased very little. Yet, prices for food and most other consumer goods were not allowed to rise accordingly to clear consumer markets. Shortages grew in the sense that existing output could not satisfy steadily increasing consumer demand, fueled by the rising money incomes. Consumers were simply earning more ruble income than they were able to spend at existing prices, creating a large overhang of unspendable rubles. The result was all the tell tale signs of consumer shortages created by administered prices set below market-clearing levels—long lines for goods, hoarding, barter, and the growth of black markets.

During 1986-90, Soviet average annual output of grain and meat was about 20 percent higher than during 1981-85, mainly because of more favorable weather. In 1990 the Soviets produced a near-record grain harvest of 235 million metric tons (the record was 237 million tons in 1978). Since labor productivity in agriculture in the republics is still only about one-tenth that in the United States, potential remains for large increases in efficiency, productivity, and output in primary agriculture. Nonetheless, the figures just given show that the reason consumer food shortages grew during the Gorbachev years is not that farm output fell.

William M. Liefert is an Economist in the Former Soviet Union Section of the Economic Research Service.

Downstream agricultural activities—transportation, storage, and processing—have arguably been the most neglected and inefficient sectors in the Soviet economy. Losses in handling could be as high as 30 percent for grain and 50 percent for potatoes and vegetables. Thus, elimination of these losses would go far to end any existing shortages. Yet, the weaknesses in these downstream activities have existed throughout the postwar period, and thus also fail to explain why consumer food shortages grew under Gorbachev.

Other Effects of Monetary Imbalance

The most serious consequence of the money overhang in the republics of the former USSR has been the decreasing acceptance of the ruble for commercial transactions. As a result, central procurement and redistribution authorities have had increasing difficulty buying output from farms. Farm managers have been more and more reluctant to sell for rubles alone. In 1991 the republics collectively purchased from farms only 53 percent of the original All-Union procurement target for grain (41 of 77 million metric tons). Since farms, enterprises, regions, and republics were all averse to giving up goods in return for rubles, crude barter, with all its inefficiencies, became the dominant means of exchange between regions and republics. During my fall 1991 trip to the former USSR, officials in all areas I visited identified the unwillingness of people to accept rubles as a major cause of food distribution problems.

The breakup of the union and collapse of the central supply system based on command have also contributed to the disruption in the flow of goods between and within republics. Yet, the undesirability of the ruble as a means of payment is a key factor retarding the development of decentralized distribution systems. At first glance one might think that with the fall of the central command system of production and distribution, a decentralized market system of exchange would then be free to develop naturally in its place. Yet, a necessary condition for well-functioning markets is that some sort of commonly accepted money exist to facilitate exchange. Enterprises, regions, and republics presently feel that the sale of their output for rubles alone is a subsidy to others. Such thinking has strengthened autarkic attitudes and fostered inefficient barter transactions.

Further, the weakening of the ruble as a means of exchange is now finally causing production itself to fall across the economy, including in agriculture. Industrial and agricultural output in 1991 in the former union dropped by 8 and 7 percent, respectively. One reason is that the decreased flow of goods throughout the economy resulted in many factories and farms not receiving necessary inputs. The money surplus also reduced incentives to work and produce. A number of times Soviet agricultural officials explained to my visiting team that attempts to stimulate more farm output through higher producer prices had in fact backfired by motivating farms to produce less. Because the value of additional ruble income was judged so low, farms' objective was not to increase revenue or profit, but produce the minimum necessary to obtain a given level of income. Higher prices allowed farms to obtain the desired income level with less output.

Another harmful consequence of the weakness of the ruble is that the need for regions and republics to barter for deficit goods is inhibiting the move toward local privatization and economic decentralization. In the food deficit region of Ivanovo oblast' (province), for example, authorities had developed almost a siege mentality for obtaining essential foodstuffs from outside. The officials used the major surplus product of the region, textiles, to barter throughout the former union for food, and then carefully handled the local distribution of the foodstuffs obtained. Thus, tight control over the goods to be bartered and obtained from bartered was necessary. Even if attractive to the authorities in the abstract, ideas about privatization and creation of a local market economy in such conditions were speculative luxuries.

By 1991 the repressed inflationary pressure of the late 1980s had finally created large open inflation. In those areas of the economy lacking price controls, prices rose at annual percentage rates well into three figures. The fear of large price rises, though, strengthened the aversion to holding rubles, and thus further weakened the ruble's power as a means of exchange.

In fall 1991 the author spent two months in the former USSR. For two weeks he was a member of a 5-person USDA team that traveled under the Protocol on U.S.-USSR Agricultural Cooperation, which expired as planned with completion of the delegation's trip. The other team members included Vernon Roningen and Richard Heifner, also of the Economic Research Service, Scott Bleggi of the Foreign Agricultural Service, and James Caron of the Agricultural Marketing Service. The team visited Moscow, Kiev, and Vilnius, the capitals of the Republics of Russia, the Ukraine, and Lithuania, respectively, and Ivanovo, a Russian industrial city about 200 miles northeast of Moscow. For six additional weeks the author remained in Moscow as a guest of the Soviet Institute of the World Economy and International Relations.

Radical Reform in 1992

After formally dissolving the USSR in late December, the republics each began 1992 with at least an official commitment to decentralizing, if not radical, market-oriented economic reform. The Russian Republic has led the way. Its radical reform program has two main objectives. The immediate one is to restore macroeconomic balance and thereby reestablish the ruble as effective money. The other is to create the institutional base for a market capitalist system, the key being privatization.

Two policy moves are now necessary to restore macroeconomic balance, and correspondingly the ruble's power as workable money. The first is that the government must prevent the further growth of inflationary pressure. This requires decreasing the budget deficit, as well as a large reduction in the growth of the money supply (which can be achieved mainly by the state banking system reducing credit to enterprises). If permitted, unbalanced budgets and easy credit would eventually increase the population's disposable money income without a corresponding rise in goods available to consumers. The Russian program has promised tough budget, money, and credit policies.

Controlled prices for food generally tripled, while those for fuel rose 3 to 5 times.

After stopping the growth, or "flow," of excess consumer purchasing power, the state must then mop up the existing "stock" of surplus rubles. The most direct way would be to free prices and thereby let them rise to their market-clearing level. On January 2 Russia began major price liberalization. Prices for many goods, such as clothing and consumer durables, as well as certain foods (meat for example), were wholly freed. Price controls for fuel, transport, and some foods, such as bread, milk, and sugar, were retained, but with prices raised significantly. Controlled prices for food generally tripled, while those for fuel rose 3 to 5 times. More prices are to be freed during 1992. The overall inflation rate during the first four months of 1992 was about 700-800 percent.

The price liberalization will restore confidence in the ruble only if the big ensuing price rises are largely a one-shot affair. The risk is that the pressure for compensation will result in major increases in wages, pensions, and other income support that lead to a ruble-destroying inflationary spiral. Through March the government's commitment to stricter budget and monetary policies had prevented the large emission of funds required for substantial increases in compensation. Admittedly, in the first three months of 1992 aggregate money incomes (including retirees' pensions) about tripled. However, since the percentage growth in prices through March had significantly exceeded the percentage rise in money incomes, the threat of hyperinflation was so far averted. By April 1992 the price liberalization had pretty much succeeded in eliminating the ruble overhang in Russia. The government's hope was that higher prices for food and other goods, in conditions of monetary balance, would not only eliminate built-up excess demand, but also stimulate production.

In April 1992, however, critics of the relatively austere reform program challenged the government's program at a meeting of the Russian Congress of People's Deputies. The reformist ministers retained power and the determination to continue reform. Yet, the government compromised by increasing income compensation, financial support to agricultural producers, and credit to enterprises. The Russian Central Bank promised to expand enterprise lending by 200 billion rubles, and might well increase loans by a further 70-80 billion rubles. The Bank also gave the Ministry of Finance a credit line of 67 billion rubles, to finance (monetize) part of the growing budget deficit. Since the money expansion multiplier for Russia is considered to lay between 2 and 2.5, the total credit growth should equal 700-800 billion rubles. Such budgetary and monetary concessions raise the fear that inflation might remain so high that it threatens price liberalization, efforts toward ruble convertibility, and other linchpins of the reform program.

In some local food markets in Russia immediately after price liberalization, the price of a kilogram of beef or pork (2.2 pounds) in state stores rose to a level equal to about one-tenth of average monthly pay.

The Effect of Food Price Increases on Consumers

The price liberalization has changed the nature of the food problem for individual consumers. Formerly the problem was finding available food to buy in barren state stores, with more rubles in one's pocket than one could find goods to spend them on. The problem now for many people is that food is available in state stores, but can one afford it at the much higher prices? The price liberalization has changed the mix and magnitude of monetary versus nonmonetary costs of obtaining food and other goods for social groups. Some will benefit from the price rises—namely, those with higher incomes who can now outbid others for goods through a flexible price mechanism. Those who suffer most will be people on less variable incomes, such as pensioners.

Some Russians argue that as a result of the price increases the bulk of the population has been, or soon will be, impoverished, such that they could face real hunger. Such fears are exaggerated. Evidence indicates that price liberalization initially resulted in food prices in certain local markets overshooting the market-clearing price. The experiences of the reforming Central European countries, such as Poland and Czechoslovakia, support this conclusion. During the 1980's these countries suffered from the same macroeconomic problems as the USSR, and during the past few years liberalized prices as the most effective way of restoring price and monetary balance. In these countries prices rose so high that consumer demand fell substantially. Rather than shortages, many food shops soon had unsold surpluses. People wondered how the now amply stocked shops had suddenly obtained so much more food, whereas in fact supplies had not increased; the food was simply remaining in shops rather than being immediately bought up. Prices eventually moved down, though, toward market-clearing levels.

In some local food markets in Russia immediately after price liberalization, the price of a kilogram of beef or pork (2.2 pounds) in state stores rose to a level equal to about one-tenth of average monthly pay. Western and Soviet data show that in 1990 per capita meat consumption in the USSR was only a little below that of a number of Western countries, such as Britain and Finland. Official statistics indicate that in 1991 the drop in aggregate meat output in the USSR was only 7 percent. This means that given the total amount of meat available for consumption, prices at which meat is unaffordable to the bulk of the population cannot be sustainable market prices. At such prices demand will fall, requiring price decreases in order for shops to avoid unsold surpluses (as in Central Europe). Such is already occurring in Russia.

How the Republics Survived the Winter

The argument that Russia has sufficient food supplies such that market-clearing prices will not deprive people of a minimally acceptable diet is related to another observation concerning the food problem: the fears of some in both the former USSR and the West that during the winter the republics might suffer from widespread hunger, if not starvation, were apparently too strong. Although the winter was not easy, the republics have survived without such extreme hardship. They had adequate supplies of bread, the diet staple, and with bread people will not starve. In December the chairman of the Russian Committee for Grain Products said that the republic had grain stocks sufficient for at least 5 months. Bread supplies should continue to be adequate until the 1992 harvest becomes available. To mitigate any localized supply shortfalls, the republics each have a government body that distributes food grain internally based largely on need. Shortages of bread, defined as excess consumer demand at controlled prices, existed during the winter. However, bread shortages defined as widespread life-threatening supply scarcity, did not.

Shortages of bread, defined as excess consumer demand at controlled prices, existed during the winter. However, bread shortages defined as widespread life-threatening supply scarcity, did not.

Yet, in many regions supplies of other major foodstuffs, such as meat, dairy products, and vegetables, became increasingly irregular, largely because of the distributional problems discussed earlier stemming from the ruble's weakness. A region is vulnerable to a supply shortfall of one of these foods if it: (a) is not self-sufficient in the good; and (b) does not produce a major commodity, whether agricultural or industrial, of high immediate demand that can be bartered for the deficit foodstuff. Thus, the regions most at risk are urban industrial areas in the north of the Russian republic, such as in the Urals and Upper Volga.