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DISCUSSION PAPER

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The Tendency to Financial Irresponsibility of Socialist Governments and its Political Consequences

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(This is a revised version of the Preface to The Role of Finance in the Transition to Socialism by Stephany Griffith-Jones - Frances Pinter 1981)

On the basis of Stephany Griffith-Jones' study of the early years of the Communist government in the Soviet Union, the Leftist coalition in Czechoslovakia after the war, and the Unidad Popular administration in Chile, it is possible to draw some general conclusions (which can also be supported by evidence from Cuba, Portugal, Jamaica, Britain, etc). Left-wing governments tend to lack firm monetary policies, and suffer not merely from a 'strike of capital' and external intervention but also from acute inflation, foreign exchange difficulties, etc. This problem leads, possibly by political coups, to policy reversals, usually accompanied by political repression. As Stephany says, it is precisely socialist governments which most need a tight monetary policy.

1/ I am grateful not only to Stephany Griffith-Jones for discussions on my interpretation of the implications of her work, but also to David Evans for some shrewd and constructive suggestions for reconstructing and expanding this preface. The responsibility, however, remains mine alone.

A pattern is visible in the life of socialist regimes. Grasping the levers of state power generates euphoria. Now at last they can raise wages, subsidise food prices, launch housing schemes, increase social services, build schools and hospitals, etc., etc. At the same time large fragments of the private sector can be taken over and made to serve public interest, not private profit.

There is of course very good justification for such measures. Objectively, no doubt, they are all essential. Moreover, they are expected by the working classes and the left-wing intelligentsia that has helped the government to power. To refrain from carrying them out may cost important political support, especially in the trade unions. But a terrible price has to be paid. Typically inflation gathers pace, and the economic situation deteriorates, leading eventually to political crisis, a complete reversal of policy, and often of the social gains.

As Stephany Griffith-Jones shows, it is precisely a socialist government, not a conservative one, that most needs deliberate and strict financial policy, especially on the budget, the rate of interest and wages. This is not merely because monetary stability is required for controls to operate efficiently and for the price mechanism to work in the sectors which cannot be controlled, at least for some years. Inflation typically jeopardises the balance of payments just at a time when opponents outside and inside the country may be trying to deprive it of foreign exchange, causing shortages of fuel, industrial inputs, food, etc. These shortages further aggravate inflation and make structural change difficult if not impossible to carry out.

A socialist government is naturally much plotted against. There are always high-ranking officers and foreign government officials only too willing to engineer the downfall of a government of this hue, if need be by violence. They are to 'blame' for what happens, of course, but - and this is something that has to be faced - a government which loses control of the economy plays into their hands and sets itself up for a coup.

Those socialist governments which have survived the traumas of birth and childishness have grown up to be extremely careful about their financial health, guarding their foreign exchange reserves with scrupulous care and imposing balanced budgets not merely in their own accounts but throughout the range of public institutions. From financial irresponsibility - and partly because of its effects - they swing to the opposite extreme, a crude version of monetarism, accompanied by political repression.

The three case histories in this book illustrate this cycle in a way invaluable for socialists who are in office or who hope to gain power in the future.

The Soviet experience immediately after the revolution of 1917 is still relevant. In the period known as 'War Communism', as Stephany shows, the inherited supply problems and price inflation were aggravated by a romantic desire to play down the importance of money or even abolish it. Only the exhaustion of the capitalist powers at the end of the war, plus the size and geographical remoteness of the Soviet Union, protected the revolutionary state from effective foreign intervention (such as helped topple Bela Kun in Hungary shortly afterwards).

Yet financial policies had to be imposed eventually. After 1922 the direction was completely reversed. The New Economic Policy then adopted would in many respects have gratified the most doctrinaire member of the IMF staff. To balance the budget, taxes were increased; part of social expenditure was made the responsibility of state and local authorities; and government administrative staff were reduced by more than 50 per cent. The increase in the money supply was halted and the currency was backed by gold. Wages were frozen, ensuring a sharp fall in their real value and the consequent strikes were repressed, often with violence; trade unions were brought under government control. Moreover, tax and price policies were manipulated to provide 'incentives' to peasants and traders. (These were apparently excessively generous reflecting a rather simplistic 'class analysis' that emphasised the need to gain the support of the peasantry and petit bourgeoisie). The rise in production was accelerated, inflation slowed down and foreign payments were brought back into balance. The regime survived - but, not surprisingly, the result of such a drastic stabilisation policy was a rapid increase in inequality and unemployment. To repress the resistance that these generated was one of the 'objective' justifications for the Stalinist terror.

In Czechoslovakia after the Second World War, the government, at first a coalition, confronted the problems of post-war chaos with a very similar naivete, its leaders declaring that the job of financial policy was simply to mobilise money for whatever investment was physically possible. Among many gems of official wisdom quoted by the author, one stands out; in a planned economy a Czech socialist proclaimed: "there can be no inflation unless the authorities wish it"!

While the government did adopt some measures to reduce excess demand, credits to the public sector grew rapidly. Price controls were partly ineffective and black markets flourished long after the war had ended. (This was in fact used by the Communist Party as a reason, not for better financial policy, but for <u>further</u> nationalisation.) The consequent economic problems, together with a deterioration in relations between the socialist and capitalist blocs, contributed to the overthrow of the coalition by the Communists in 1948. There was a shift towards financial orthodoxy which was facilitated by Communist control of the trade unions, but it was accompanied by (and not unrelated to) increasing political repression, which became severe in the 1950s.

In parts of the world further from the reach of the Red Army, socialist governments cannot be saved from the consequences of financial irresponsibility; on the contrary, internal and external enemies can combine to exploit these with every prospect of success. A prime example is the third case study in the book, the Allende administration in Chile. As the author (herself an official in this regime) recognises, it is difficult to criticise the 'Popular Unity' government without seeming to exonerate the military officers, who overthrew it with US support. However, analysing its mistakes may help others to avoid repeating them yet again.

Unfortunately, the Allende government did not draw on - probably for the most part did not know of - the experience of the Soviet Union and Eastern Europe. Their attitudes had been formed, naturally enough, rather by the struggle, since the Second World War, against the naiveties of 'monetarism' in Latin America. They saw the fundamental problems as 'structural': finance was of quite secondary importance. Theories of "planning" then current in Latin America carried the implication that social problems could be solved by inverting input-output matrixes and building 'consistent' projections for some imaginary future. Versions of Keynesianism almost as naive implied that what was physically possible must be financially possible too, reinforcing the tendency to hive off financial policy and down-play its importance.

Many simplistic errors were made by government economists in the analysis of Chile's problems. Indeed since inflation was due to structural problems, the structural reforms they planned would be accompanied by growing monetary stability. There was spare capacity in both labour and capital and they could count on an acceleration in economic growth. Their very electoral programme set the stage for economic crises by promising on the one hand, big increases in wages, on the other no simultaneous "imperialist devaluation".

However, there were considerable organisational problems about actually carrying out the reforms and mobilising the surplus capacity. Moreover, the fiscal deficit climbed rapidly, as the author shows. Revenue was falling far short of what was needed (partly because of insufficient government strength in Congress to legislate higher taxes, partly due to a fall in the price of copper). Yet the government was unable to curb expenditure, and public sector wages showed very big increases. (In Chile the trade unions could not be so easily converted into state instruments as in the Soviet Union and Czechoslovakia.) Since prices were controlled, the results were enormous deficits in the public corporations, the number of which was growing rapidly as the main companies were taken over. Interest rates were held down to negative levels in real terms.

The consequent rapid acceleration in price inflation to more than 500 per cent a year stimulated the outflow of private capital and caused black markets to proliferate, especially in foreign exchange. 1/ Not merely was the government unable to control demand; it did not have the power to introduce rationing either, except on an informal basis. In its last months, industrial production declined because of dwindling supplies of raw materials and spare parts, and big strikes, politically stimulated. Housewives faced growing shortages and queues and many joined public demonstrations of protest.

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1. In 1972 a fascinating international conference on the government's policies, jointly organised by the Chilean planning office (ODEPLAN) and IDS, was held in Santiago. Participants from Communist countries could hardly conceal their shock at hearing one of Allende's ministers say that the exchange rate did not matter ("because the government controlled both exports and imports"!)

The stage was set in 1973 for a reversal of policy here too. The geographical position of Chile, and the major investments there by US companies, made it much more vulnerable. Moreover, the government coalition, 'Popular Unity', was really somewhat misnamed - its popular base was never very broad or secure, and it consisted of a group of competing parties, each with their own trade union base and their own formula for socialism, blaming the others for 'reactionary' tendencies.

As earlier in the Soviet Union and Czechoslovakia, the pendulum has swung right back. 'Monetarist' policies have been imposed and opposition to them brutally repressed - but in this case under a 'Right-wing' banner.

Stephany's analysis is confined to these three leading cases. But there have been in fact several experiences in other parts of the world which confirm the pattern. Let me briefly summarise them.

In Cuba post-revolutionary euphoria led in the 1960s to a contempt for financial policies, indeed even for money itself, more profound even than in the Soviet Union in 1918. Indeed state corporations ceased to keep accounts. Massive Soviet aid prevented the collapse of the regime, but in 1970 falling output and shortages of consumer goods led to social troubles (of a seriousness which we cannot judge from outside). In this case, the government was able to carry through an almost complete reversal of policy, and there is now here too a new insistence on monetary incentives, balanced books, limits to supply of money, etc. A degree of unemployment appeared - and political controls have been tightened.

In Portugal, after the quasi-revolution of 1974, successive governments went through the same cycle. Public expenditure increased rapidly and although the economic consequences were cushioned at first by a big stock of gold, the severe external disequilibrium forced in due course the adoption of restrictive financial policies and recourse to the IMF, with predictable consequences for social policy and unemployment. The political pendulum swung gradually further to the Right.

Michael Manley's government in Jamaica also let the financial situation get out of hand, partly because one of the two trade union organisations is controlled by the then opposition. Simultaneously, pro-Cuban rhetoric and measures against the bauxite companies led to a net flight of capital. The withdrawal of IMF support was hardly a surprise, and the deteriorating economic situation and increasing violence set the stage for an election which swept the government out of office and brought about a predictable reversal of policy.

Mildly socialist governments seem to show mild tendencies to financial irresponsibility with correspondingly less drastic consequences. Is it far-fetched to see certain parallels even in recent British history? The Labour government of 1974-79 could hardly be called socialist but it attempted to shield the working class from the consequences of the post-colonial economic decline, at the cost of budgetary discipline. Policy was already starting to swing in its closing years; the Chancellor, Dennis Healey, obtained from the IMF both financial and political support, but wages policy collapsed and here too the government was replaced by one dedicated to financial respectability, at the cost of rapidly rising unemployment, and civil liberties are under somewhat greater pressure.

How many more political disasters, one wonders, over how many decades have to take place before the Left draws the lessons of this book? In the first place, commitments to wage increases, heavy investment in social infrastructure, etc., help a party gain power, but they greatly complicate its life once it has succeeded. The experience documented here shows that big gains of this kind cannot be made in the early years of socialist governments. These only take power at a time of national crisis, which leaves a legacy of financial disequilibrium. The civil service, inherited from the earlier regime, is unlikely to be willing, or even able, to implement far-reaching reforms. The structural changes that are attempted, such as land reforms and nationalisation, cause - in the first instance at least - disorganisation and declines in output. Capitalists, especially the transnational corporations, cut investment and export capital.

A Left-wing political leader hoping to achieve power ought to ensure, especially after the experience of Chile, Jamaica, etc., that a proper financial policy, especially an incomes policy, is worked out in advance to cover this period of disorganisation. Yet no socialist party, to my knowledge, including the British Labour Party, attempts to do this. Honesty, if not mere prudence, also requires that even while still in opposition socialist leaders should not promise the public more than can actually be delivered - emphasising how much depends on oil prices and other factors outside their control. This might jeopardise the chance of victory, but we can now see that the victory may otherwise prove hollow and short lived.

The theorists and ideologues of the Left could also well turn from grand models of the world system and spare some attention for the following question: what financial guidelines would meet the needs of socialist governments, especially in countries dependent on importing oil and exporting primary products that are subject to wild price fluctuations and harvest vicissitudes? When there are no agreed rules, all the finance minister in a Left-wing government can do is to nag his colleagues not to spend quite so much - before going to the other extreme becoming plus Friedmanite que Milton!

Such guidelines cannot of course go very far in general terms - much depends on the size of each economy; the composition of its balance of payments; its trade union policies; its productive structure; the nature of capital markets; the capacity of the public service (and its own political interests). One can, however, draw up a sort of check list of points to look for. These would include the principles and machinery for an incomes policy; the limits on the supply of money (that have to take account of existing inflation and price rises due to structural change, but have nevertheless to be set <u>somewhere</u>); the rules for public corporations.

Financial guidelines are even more urgently needed now that the chronic foreign exchange surplus of oil-exporting countries is reflected in a chronic deficit in the rest of the world, a situation that can be expected to continue, on and off, for at least a decade (until alternative cheap sources of energy have been developed on a very large scale). Any socialist government taking office will almost certainly inherit a state of near-bankruptcy with low liquid external assets, heavy debts, and a trade deficit. (The above analysis suggests interesting questions about the Mitterand government in Paris (especially bearing in mind the experience of Leon Blum), and about future Polish policy.)

Sooner or later such governments seek help. The Soviet Union has barely enough capacity to support a handful of clients (Cuba, Ethiopia, Afghanistan, South Yemen, South Vietnam, etc.) There are of course many sources in the capitalist world - private and governmental - but rarely will any of them provide much capital until the International Monetary Fund has put its seal of approval on the financial policy.

Left-wing economists criticise the Fund's political bias, in insisting on the dismantling of controls (except of course those over wages), a bias not required by its Charter. These complaints are well-taken but they seem somewhat immature. What can one expect from an institution controlled by the major capitalist governments, which gain from other economies being 'open'? There is no secret about this control; they have the big majority of the voting power in its directorate.

In any case, the need for a strict financial policy does not arise, fundamentally, because of the prejudices of the IMF (useful though this may be as a whipping boy), nor even because of the strength of the capitalist powers. It arises out of the objective situation, especially the inconsistency between the aspirations of a socialist government's supporters, which will have been stimulated by 'consciousness raising', and the inevitable drop in living standards, at least in the short run, for the reasons outlined in this book. This is one of the typical internal contradictions in a new socialist state, and leads to the usual accelerating inflation, dwindling foreign exchange reserves, difficulties in financing essential imports, etc. etc. Indeed much of what the Fund imposes in 'conditionality' governments would have to carry out anyway, even if it did not exist. To my knowledge, Finance ministers, including socialists, who are at the end of their tether, and more so their officials, often secretly welcome powerful outside pressure on their cabinet colleagues to behave at least in ways more consistent with financial equilibrium.

Every Left-wing leader should buy this book and distribute it to those who may become Ministers. If it is widely circulated, the 1980s could prove a less disastrous decade for the Left.

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