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The Soviet Union in Search of a New Economic Model

by Andreas Polkowski, Hamburg*

Seventy years after the Bolshevik Revolution the Soviet Union is to embark on a new economic path which, according to Mikhail Gorbachev, will again call for revolutionary measures. What form will these measures take? What obstacles stand in the way of the planned reforms? What are their chances of success?

Unlike his predecessors, Mikhail Gorbachev does not indulge in rhetoric about overtaking the West in terms of economic performance. The Soviet leadership takes a realistic view of the present economic situation of their country and the scope for future development. "Quite clearly, they have recognised the danger that the Soviet Union may slip further behind the West in terms of economic development until the turn of the century and that this could have serious consequences for the attractiveness of socialism at home and abroad and hence for the standing of the Soviet Union in the world, its internal stability and its hegemony in Eastern Europe."[1]

The main economic indicators highlight the wretched state of the Soviet economy. Whereas the average annual rate of growth in industrial output was still around 10 % in the fifties and sixties, it fell to 5 % in the seventies and 2 or 3 % in the eighties. The gross national product of the Soviet Union grew continuously from 1960 to 1986, but the rate of increase was appreciably slower than in the leading Western industrial countries or in China, which was catching up rapidly.

It must be borne in mind in this context that the cost-benefit ratios of GNP growth in the Soviet Union – measured in terms of energy, primary products, materials and labour – were several times higher than in Western industrial countries. As a result, limitations on extensive growth in the Soviet Union emerged fairly quickly.

Even though the USSR already produces twice as much steel as the USA, three times as many machine tools and 2.7 times as many pairs of shoes, there is no disguising the fact that its export structure resembles that of a developing country and that there are serious supply shortages in the domestic market. Future Soviet development will not be aimed primarily at increasing output; rather, the USSR must improve the quality of its goods and, more important still, find ways and means of raising the economy's ability to innovate and incorporating the new advanced technology into production processes. This challenge is to be met by means of a process of intensification in the Soviet economy, whereby intensification is understood to mean both the modernisation of industry and the more rational use of production potential. Gorbachev lays the main emphasis on promoting engineering. At a meeting of the Central Committee of the Communist Party in June 1987 he announced that the Soviet engineering industry should reach the highest international standards in the next six or seven years;[2] in the past, it had not been expected to achieve that level until the five-year planning period after next (1996-2000). The USSR clearly wants to speed up the modernisation of the engineering industry, in the belief that only the use of modern machinery can solve several of the technological and economic problems now facing the country.

Nature of "Perestroika"

In order to bring about rapid structural change and to make a modern and attractive economic model a reality, Gorbachev has already taken a number of measures that amount to a fundamental modification of the Soviet economy and of Soviet society. Like his predecessor, he began with a campaign to tighten discipline and to combat corruption and alcohol abuse, but he clearly realised from the outset that these measures could have

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[1] Cf. D. Lösch: Gorbatschows wirtschaftliche „Wende" – Ziele, Mittel und Erfolgschancen, in: Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik, Vol. 31, 1986.

[2] Cf. Nachrichten für Außenhandel, No. 142, 29. 7. 87.

only a limited economic impact and that the real potential of the Soviet economy could be set free only by fundamentally altering the system of management and planning.

The restructuring of the economy is designed to achieve three overall aims:[3]

☐ a major structural shift of emphasis from extensive to intensive development, coupled with an acceleration in technological progress;

☐ a radical reform of economic management, with the ultimate intention of changing over from administrative methods of management to primarily indirect control;

☐ adaptation of the social sphere and the supply of services to suit the new methods of production.

The increased activities in the social field (more resources to build housing, schools and hospitals) and in the services sector are designed to create the "social infrastructure" required for the economic reforms themselves. When he came to power in 1985, Mikhail Gorbachev stated that the Soviet people would have to perceive a rapid improvement in their living standards if they were to support the "revolutionary change". This was based on the conviction that the planned reforms only stood a chance of success if the population could be motivated to increase their performance.

The policy of "glasnost" and the announced changes in the political system are also aimed at creating the necessary "social infrastructure". Clearly, the Soviet leadership has analysed the experiences of smaller brother countries whose economic reforms made no headway since they were not accompanied by political changes, which at the time were not favoured by Moscow. How far the Soviet leadership is really prepared to go remains to be seen.

Lack of a Theoretical Basis

The restructuring of the economy centres on the system of management and planning. The "Main outlines of the fundamental restructuring of economic management" drafted by the Politburo and the Government lists the following objectives:[4]

☐ far greater autonomy for industrial production organizations (obyedinenie) and enterprises, a switch to full economic accounting and self-financing, the establishment of a direct link between the income of the labour collective and the effectiveness of its work;

☐ a fundamental restructuring of the central management of the economy with the aim of strengthening its strategic functions and leaving operational activities to the enterprises themselves;

☐ a fundamental reform of planning, pricing and of banking and finance;

☐ the creation of new organisational structures;

☐ the development of self-management and a fundamental change in the style and working methods of party, state and economic organs.

The above objectives answer the question of *what* must be changed in order to steer the economy onto the intensification path, but say nothing about the means of doing so. "Our task now", says Abalkin, "is to turn a partial concept into a fully-fledged model, in other words we must state in concrete terms how the plan, prices, finance and credit are to function, how they are to be interlinked", and he admits that "such a model does not exist".[5]

[3] Cf. A. Aganbegyan: Umbau der sozialistischen Wirtschaft ist keine kurzfristige Kampagne, in: Handelsblatt, No. 9, 14. 1. 87.

[4] Cf. M. Gorbachev: Radykalna reforma zarządzania gospodarką – najważniejszym ogniwem przebudowy, in: Trybuna Ludu, No. 148, 27.-28. 6. 87, p. 5.

[5] Cf. Romantyzm i realia gospodarki, an interview with L. Abalkin, in: Polityka, No. 47, 22. 11. 86, p. 11.

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The fact that no such model exists today can be blamed on the shortcomings of theoretical economics, which in the past only interpreted economic events and did nothing to develop economic theory further. The Leninist theories of socialism were interpreted simplistically and their theoretical depth and significance were often left emasculated, says Gorbachev, adding that the situation on the theoretical front has had a negative effect on the resolution of practical problems.[6] It is all the more difficult today to translate a general reform concept into action.

New Role for Enterprises

The advocates of reform must make haste, however. "Perestroika" must come about first in the enterprises. Gorbachev justifies this on the grounds of economic logic, but it may also be due to the fact that the central authorities find it easier to monitor a changeover in the enterprises than to reform themselves. In the near future, however, the role and responsibilities of central economic management must be reformulated and its organisational structure redefined (limit on the number of specialised ministries, strengthening of the functional central bodies), which will certainly be resisted by those directly affected. The new law "on the state enterprise (state industrial production organization)",[7] which is designed greatly to increase the powers of decision and commercial freedom of enterprises or industrial production organizations, has its origins in the so-called great economic experiment of 1984. The key elements in the reform are the changeover of enterprises or industrial production organizations to "full economic accounting and self-financing" and a substantial degree of autonomy in the preparation and execution of the enterprises' plans.

The law will come into effect on 1st January 1988; before then a series of decrees is expected on the reorganisation of the economic activity of central authorities and territorial management bodies. Within the new framework created by the law, the enterprise (the industrial production organization) becomes the basic unit of the economy. It will now draw up its plans independently and hence will also decide itself on the volume of output and the product range. The information it needs for this purpose will be provided in the form of control indicators (kontrolnye tsifry) – macroeconomic aggregates –, long-term economic parameters (dolgovremennye stabilnye normativy) – e.g. tax rates – and limits – central allocation of materials. The previous central plan requirements will be replaced partly by state contracts that the plant will be obliged to fulfil. Factories' plans will also take account of contracts that the management will negotiate with buyers of the plant's products.

In future there will essentially be two ways in which the enterprise can procure machinery, equipment and materials; it can simply purchase the resources it needs from wholesalers on a contractual basis without govermental restrictions, or it can be allocated them, as at present, via a centralised allocation system. Enterprises will be expected to obtain most of their supplies from wholesalers. In principle, they will be required to be profit-oriented. Socialist competition will no longer aim to motivate enterprises to fulfil or overfulfil their plan requirements, as in the past, but to spur them on "in the battle to achieve the highest possible satisfaction of consumer demand for high-quality, competitive products at least cost". Enterprises that become insolvent as a result of inefficiency can be declared bankrupt.

As indicated above, the higher body (ministry, state committee or other central authority) will control the enterprise mainly by using economic methods based on control indicators, state contracts, long-term economic parameters and limits. Whereas the control indicators are non-binding indicative aids for enterprises when drafting their plans and concluding business contracts, the long-term economic parameters govern the formation of enterprises' funds as well as their relationship to the state budget and the bank. Economic autonomy and self-financing are to be complemented by self-management, entailing participation of the workforce in plant activities and the election of the plant management. Under the law, managers are to be elected for five years, subject to confirmation by a higher-ranking body.

Independence, self-financing and self-management are cornerstones of "perestroika", but the law on enterprises alone is not sufficient to ensure the success of the reform. Much, and perhaps all, depends on the future powers of the central authorities, the price reform, the reform of banking and credit and the strengthening of the role of the wholesale trade. Without these, "all the innovations in the economic system must remain disjointed pieces".[8]

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[6] Cf. M. Gorbachev: O perestroyke i kadrovoy politike, in: Pravda, No. 28, 28. 1. 87.

[7] Cf. Zakon o gosudarstvennom predpriyatii (obyedinenii), in: Izvestia, No. 182, 1. 7. 87; see also Das sowjetische Betriebsgesetz, Ein Vergleich von Entwurf und Endfassung, Working Papers, No. 121, Osteuropa-Institut, Munich.

[8] See Preisreform für UdSSR unabdingbar, Gespräch mit M. Maximowa, in: Außenhandelsdienst, No. 30, 30. 7. 87, p. 10.

Changes in the Pricing System

The success of the economic reform depends on far-reaching changes in the pricing system above all else. The leadership is calling for changes in pricing methods as well as reform of the price structure. Even Soviet economists describe current prices as "bent", since most of them have not changed in the last twenty years and no longer reflect presentday scarcity values. A good example of this is the price of coal, which for decades has been kept artificially low, far below production costs. Because of the low price of coal, the prices of oil and gas are also distorted. It is estimated that fuel and raw material prices are between 33 and 67 % below world market prices. As a result, costs are artificial throughout industry, but especially in heavy industry. Similarly, the retail prices of foods are kept so low that production has to be heavily subsidised. For instance, the state pays 3 roubles on every kilogram of meat and 0.40 roubles on each litre of milk.[9] It is also common knowledge that farmers find it cheaper to feed pigs on bread than on potatoes or grain because of the heavy bread subsidies. Food price support alone costs 48 billion roubles a year, 12 % of total budget expenditure. According to the Soviet price authority, state subsidies on goods and services now amount to more than 73 billion roubles, accounting for around 20 % of the budget.

Subsidies have therefore gone far beyond the economically acceptable limits and there is an urgent need to reduce them. According to Pavlov, the head of the price authority, the existing price system "no longer generates sufficient incentive for economic development" and "has ceased to be a sound basis for planning decisions".[10] Hence the aim of the reform is to create a new price structure so that price can serve as an economic parameter in plant accounting. To achieve this end, the enormous subsidies must be reduced, which will lead to a rise first in industrial costs and then in consumer prices.

Contradictory Concept

Public discussion of the price reform proposals is imminent, but there are many issues that must be clarified first.[11] There are still glaring contradictions between different aspects of the reform concept. For example, the official line is that the price mechanism is to stimulate technological progress while not triggering inflation. There is still argument about the pricing principle to be used; some wish to uphold the principle of cost coverage, while others advocate demand-oriented pricing. Pavlov says in this regard that the prices of coal and natural gas are to be set "on the basis of their real cost and taking account of world market prices"; they are to remain valid for a period of ten years.

This does not suggest radical reform, more an attempt to appease both the central planners and the advocates of plant autonomy. Time is short, however, and a fully developed concept is urgently required. It has been announced that the reforms are to take effect as early as January 1990.

As far as pricing principles are concerned, the reform aims to widen the range of so-called "agreement prices", that is to say essentially contractual prices freely negotiated between enterprises and organizations. Only the prices of strategically important products will continue to be set by the central authorities. More detailed information is not yet available, however. The demand that price reform should create the conditions for improved efficiency without impairing the standard of living creates a delicate political dilemma of which the Soviet leadership is only too well aware.

Expansion of Credit Financing

The changeover to an efficient and more flexible system based on economic accounting also requires a reform of the banking and credit system, which emerged in its present form around thirty years ago. At present the banking and credit system is dominated by two large banks: the State Bank (Gosbank) for day-to-day economic activity and the Bank for Construction (Stroibank) for investment. Until now Stroibank has scraped along in the shadow of Gosbank, owing to the fact that its loans finance only 4 % of Soviet investment. The smallness of lending in relation to the total value of investment is a consequence of the centralised economic system, since an overwhelming proportion of investment is financed by allocations from the state budget, which are regarded as loans but do not have to be repaid.

The reshaping of the economy should increase the importance of loans. It is hoped that the use of credit will unlock enterprises' underutilised resources for investment. Soviet banking circles indicate that the proportion of investment financed by means of credit should rise to between 20 and 30 %. Although this would be several times the present ratio, the limits of

[9] Cf. A. Aganbegyan: Początek trudnej drogi, in: Trybuna Ludu, No. 149, 29. 6. 87, p. 6.

[10] Cf. W. Pavlov: Radikalnaya reforma tsenoobrazovaniya, in: Pravda, No. 237, 25. 8. 87, p. 2.

[11] Cf. A. Nove: Radical reform, Problems and prospects, in: Soviet Studies, No. 3, 1987; Yu. Borosdin: Tseny, intensifikatsya, effektivnost, in: EKO, No. 7, 1987.

decentralisation in the investment field are also evident. No measures to implement the reform of the banking and credit system have been enacted so far. One will certainly have to wait until the end of the eighties for the existing and proposed new banks[12] to change over to full economic accounting.

Until that happens much will remain unchanged in enterprises too. For the time being the central bodies will keep the upper hand, for according to Aganbegyan, state contracts will absorb "50 to 60% of output, and perhaps even more". Only after the reform of prices and of the banking and credit system will their share be limited to between 25 and 30%.[13]

Towards Reform of Foreign Trade

The external sector is also an important element in the restructuring of the Soviet economy. For decades foreign trade activities have been very highly centralised, with more than 90% of the total volume being handled by Foreign Trade Organizations. This meant that producers were cut off from foreign markets. The organizational, planning and economic separation between production and foreign trade has harmed the volume, structure and efficiency of foreign trade and hence also the efficiency of the entire economy. As a result, the Soviet Union has a share of only around 4% of world trade, despite the fact that Soviet industrial production now accounts for 20% of world output. Exports to the West consist 80% of energy and raw materials, which have fallen sharply in price, reducing foreign exchange earnings and limiting the country's import potential. In recent years Soviet economists often stressed that the Soviet Union's share of world trade did not reflect the level of economic development the country had reached nor meet its development needs.

The measures affecting the foreign trade machinery that were taken on 1st January 1987[14] and the law on enterprises aim to integrate foreign trade fully into the economy as a whole and hence to involve foreign trade in the intensification process. Twenty-one specialist ministries and central government bodies and around 70 industrial production organizations and enterprises were granted the right to trade independently abroad. These decisions affect 26% of total Soviet imports and 14% of total exports, including more than two-thirds of exports of machinery and equipment.

Loosening of the Foreign Trade Monopoly?

In this connection there is often talk of a loosening of the foreign trade monopoly in the Soviet Union. Clearly this overlooks the fact that the recent measures also include the creation of a new supreme body, the state foreign trade commission within the Council of Ministers, which will have powers over all ministries and enterprises with foreign trade rights and over the Foreign Trade Ministry. Hence it is less a question of loosening the foreign trade monopoly than adapting it to suit present conditions. This view is shared by J. Shamrai, Head of the Department for Foreign Trade of the USSR at the Economic Research Institute in Moscow. He asks "can one interpret the changes taking place in foreign trade as a reduction in the state monopoly of the foreign trade of the USSR?", and adds "there can only be one answer to that question: the principle of the state monopoly over foreign trade is being developed further under new conditions".[15]

Management methods are to change as well as the way in which foreign trade is organised. The aim of the measures is to create a new economic mechanism for foreign trade relations, in keeping with the new conditions and methods of economic management. This is expected to increase industry's economic independence in foreign trade and hence its responsibility for the development of exports and imports. Various methods will be employed to stimulate the interest of enterprises and industrial production organizations in expanding exports and using imports rationally, such as allowing them to have their own foreign currency funds and including profits from foreign trade activities in their overall operating results.

It is still unclear how all these innovations are to be put into effect. Many questions remain, such as the means of establishing the price relationship between the domestic and external markets and the exchange rate that should be set for the rouble. Solving these issues will be a complex matter and will have to take account of the links between these and all the other external and internal problems.

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[12] In future there are to be six independent banks in the USSR – Gosbank as the note-issuing bank, the Foreign Trade Bank, a Bank for Industry and Construction, an Agro-Industry Bank, a bank for the communal and housing sector and for social development and a bank for workers' savings deposits and consumer credit. The last two have already been set up. See N. Ryzhkov: O perestroyke upravleniya narodnym khozyaystrom na sovremennom etape ekonomicheskogo razvitiya strany, in: Pravda, No. 181, 30. 6. 87, p. 4.

[13] Cf. A. Aganbegyan: Początek trudnej drogi, op. cit.

[14] With regard to measures to improve the management of the Soviet Union's foreign trade relations, see supplement to the journal Außenhandel der UdSSR, No. 5, 1987.

[15] Cf. J. Shamrai: Die Umgestaltung des Systems der Außenwirtschaftsbeziehungen der UdSSR und das staatliche Außenhandelsmonopol, in: Außenhandel der UdSSR, No. 4, 1987, p. 8.

Joint Ventures

Whereas the restructuring of the foreign trade system is a protracted affair, Moscow hopes to reap more immediate benefits from joint ventures with western companies as part of the modernisation programme instigated by Gorbachev.[16] By authorising joint ventures, Moscow is pursuing a number of subordinate objectives, ranging from the import of capital to the transfer of technology and managerial and organisational know-how.[17] There are conflicts of interest here between the Soviets and their Western partners about the marketing of the goods produced. The Soviet Union aims to use joint ventures to strengthen its export ability and to increase its foreign exchange earnings, while Western companies would like to expand their sales of goods and services in the enormous Soviet market.

The fairly keen interest Western firms have shown in joint projects reflects the strong attraction of the Soviet market for Western businesspeople. According to the Soviet authorities, more than 200 offers have already been received from every part of the world; however, the projects that have actually been agreed can probably still be counted on the fingers of one hand. Only two or three of the first hundred proposals stemmed from initiatives by Soviet enterprises. This strong reticence on the part of Soviet enterprises can be explained by the fact that

- the technological gulf makes joint projects difficult;
- enterprises find it difficult to forego the protective shield of the planning system; and
- the initiative for joint projects lies with the central authorities, which do not take the interests of the enterprise into consideration.

Factors of relevance to the enterprise, and an interest in joint ventures on the part of enterprises, may take on decisive importance in the Soviet Union only when the reforms have been successfully introduced. Until the principles of "perestroika" have permeated the Soviet economy, joint ventures will be an interesting experiment but will continue to be of little importance as far as the pursuit of national economic goals is concerned.

Opposition to Reform

Gorbachev's economic reform, with its known theme of improved performance and greater individual responsibility, does not enjoy universal approval in the Soviet Union. According to Aganbegyan, opposition is coming from four different groups:[18]

- departmental heads and ministry officials who are resisting relinquishing some of their power;
- factory managers and the chairmen of collectives, who in the past merely followed instructions and shy away from taking decisions on their own responsibility;
- workers and collective farmers who received good wages but who did little work or were unproductive;
- antisocial elements.

For these people, he says, privileges and guaranteed wages unrelated to the work performed are of greater interest than any performance-linked wages associated with "perestroika". They are rallying around the orthodox "old guard" party officials who are trying to justify their opposition on the grounds of "theoretical considerations", warning of the dangers of the new course for "socialism" and claiming that the planned economy and the market economy are incompatible. Such opposition is typical for every kind of reform that seeks to reduce state control and introduce greater efficiency.

This demonstrates the dynamite contained in the reform. As Gorbachev emphasises, for this very reason revolutionary measures are called for. "Perestroika" still faces many obstacles that could pose a serious threat. The danger could grow worse in the event of:

- lack of resolve in implementing the reform;
- a deterioration in living standards as a result of the change of direction; it will be several years before "perestroika" can show success in the shape of an increased supply of consumer goods;
- a rising tide of demands for national self-determination (problems with minorities), that could prompt anti-reformists to take measures against the reforms.

Finally, it should be noted that the chances of success of the Gorbachev reform are viewed less optimistically in the Soviet Union than in the West. Nevertheless, Gorbachev's approach is recognised to be revolutionary inasfar as he officially acknowledged the economic decline of his country and took steps to reverse it. Even if he does not make a resounding breakthrough, it is already certain that the Soviet economy and Soviet society will take on a completely different appearance.

[16] Cf. O poryadke sozdaniya na territorii SSSR i deyatelnosti sovmestnykh predpriyatiy s uchastiyem sovetskikh organizatsiy i firm kapitalisticheskikh i razvivayushchikhsya stran, in: Izvestia, No. 28, 28. 1. 87.

[17] Cf. K. Bolz: Deutsch-sowjetischer Handel – quo vadis? in: Wirtschaftsdienst, No. 8, 1987, p. 374.

[18] Cf. Handelsblatt, No. 126, 7. 7. 87, p. 8.