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Gorbachev's "Radical" Economic Reform Package: An Initial Evaluation [redacted] 25X1

An Intelligence Assessment

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SOV 87-10081
December 1987
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Declassified in Part - Sanitized Copy Approved for Release 2012/03/07 : CIA-RDP08S01350R000300900001-5

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An Intelligence Assessment

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Gorbachev's "Radical" Economic Reform Package: An Initial Evaluation

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Scope Note

This paper provides a detailed description and initial evaluation of General Secretary Mikhail Gorbachev's program of economic reform as it is laid out in several major decrees adopted in 1985 and 1986 and in the documents approved at the Central Committee plenum in June 1987. The paper does not deal with the experimental reforms carried out during the period 1985-87 or the continuing debates over reform provisions. The paper also does not address the political consequences of the June plenum or the political aspects of the economic reforms per se. 25X1

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Gorbachev's "Radical" Economic Reform Package: An Initial Evaluation

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Key Judgments

Information available as of 13 November 1987 was used in this report.

Following a period of debate and experimentation, the Soviet Government in late June 1987 adopted a set of documents mandating the most comprehensive reform of economic management since the introduction of Stalinist central planning in the late 1920s. The key documents are the Basic Provisions for Fundamentally Reorganizing Economic Management, the Law on the State Enterprise, and 11 decrees dealing with major aspects of the reform. Supplemented by several decrees adopted in 1985 and 1986, this package provides the present operational blueprint for Gorbachev's "radical" economic reform and the timetable for carrying it out. Through these reforms and a spate of policy measures already adopted, the leadership hopes to achieve a sharp acceleration in economic growth, a major breakthrough in productivity, and a drastic improvement in the technological level of the capital stock and the quality of products.

The major provisions of the reform package are the following: 25X1

- Reduction in the directive role of central plans, reducing details and changing forms.
- Redefinition of functions of the central bureaucracies and ministries, reorganizing them and cutting their staffs, but also creating new superministries to manage various economic complexes and large, state production associations to manage groups of enterprises.
- Extension of the authority of republic and local governments, especially in matters concerning consumer welfare.
- Considerable expansion of the autonomy of enterprises, which now will be required to formulate their own five-year and annual plans on the basis of state-set parameters and to finance their activities from their own revenues. Provision also is made for election of enterprise managers and establishment of enterprise labor councils.
- A gradual conversion of much of the present system of rationing raw materials and capital goods to a reliance on wholesale trade.
- Revision of centrally set prices to raise their level and to link wholesale, procurement, and retail prices for all important products; considerable expansion in the use of contract prices negotiated between enterprises.

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- A complete overhaul of wage and salary scales and work norms intended to link each worker's pay to his productivity.

- Delegation of limited authority to ministries and enterprises to engage directly in foreign trade and to undertake joint ventures with firms abroad.

- Expansion of the scope accorded to economic activity by private individuals and producers' cooperatives.

- Management of agriculture and related industries through a new superministry, with farms directed to operate under essentially the same rules as industrial enterprises and to organize production on the basis of contract teams. [redacted] 25X1

The schedule for implementing the reform package calls for it to be almost fully in place by the beginning of 1991, the first year of the 13th Five-Year Plan. Parts of it are already in effect. Seven superministries were established and some ministries abolished, created, and combined during 1985-87, and the wage reform and the new laws on private activity took effect in the first part of 1987. Reorganization of the central and regional bureaucracies is supposed to take place during 1987 and 1988. The Law on the State Enterprise becomes effective on 1 January 1988, and the 1988 plan has been formulated in accordance with the new procedures. All firms and farms are scheduled to become self-financing by the end of 1989. Transition from rationing to wholesale trade is to be completed by 1992, when it is supposed to encompass 75 to 80 percent of Gossnab sales. A major revision of industrial wholesale prices takes effect at the beginning of 1990 and revision of agricultural procurement prices one year later. Although no date has been announced for any revision in retail prices, the entire price reform is supposed to be completed by 1991. [redacted] 25X1

Taken as a whole, the reform measures put in place in Gorbachev's two and a half years of tenure are an impressive package that in scope and specificity goes well beyond the so-called Kosygin reforms adopted in 1965. It also sets tight schedules for implementation. The intent is to substantially reduce the role of directive plan targets and of the central bureaucracies in management of the economy and to provide wide latitude for individual enterprises to make their own decisions about what and how to produce and to deal directly with their customers and suppliers through contracts. [redacted] 25X1

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Despite the many allusions to autonomous, self-financed, and self-managed firms competing to woo customers, the reforms do not go nearly far enough to create a market environment for those firms, as Lenin did in 1921 with his New Economic Policy. Nor do they allow the workers' collective to make the key decisions determining the firm's activities, as is done in Yugoslavia. Rather, the reform package as now constituted is a set of half measures that leaves in place the pillars of socialist central planning: state ownership, the framework of central plans (albeit reduced in detail and changed in form), numerous old and new administrative agencies overseeing and partially directing the activities of enterprises, rationing of many raw materials and investment goods, rigid state-fixed prices for key products and detailed state monitoring of all others, and enterprise incentives geared to meeting plan goals for output and oriented toward dealing with administrative superiors, rather than following signals from markets. Moreover, the reform package contains inconsistencies and contradictions that, if not resolved, will seriously limit its effectiveness.

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Because of such internal contradictions and the retention of so many elements of the present system, the reforms, even if fully in place in 1991 as intended, will not create the dynamic, self-regulating economic mechanism that Gorbachev seeks as the means to reduce or close the technological gap with the West. The hoped-for acceleration in productivity growth will be frustrated by the still large presence of those systemic features that produced sluggish growth in the past. Nonetheless, the reforms may yield some benefits. The financial pressure on enterprises should lead them to shed redundant workers and reduce gross waste of materials. Efforts to put producers more closely in touch with consumers may result in higher quality products that are better tailored to demand. Consumers will benefit if private and cooperative activity expands rapidly, as is hoped.

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At the same time, vigorous implementation of the present reform package could seriously disrupt the production process in the next few years. The pressure now being exerted on the enterprises to meet ambitious plan targets and to speed up plant modernization increases the danger. Specifically, the switch to new and unfamiliar supply arrangements may disrupt the flow of materials to firms and create bottlenecks. Changes in the way producer goods are obtained could foul up the investment process. Enforcement of self-finance will put many enterprises in severe financial straits.

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Because of the vague and ambiguous language of the many relevant laws and decrees, the relationships between enterprises and their supervisory agencies will be confused—a situation hardly conducive to speedy decision-making. Matters will be made worse because these agencies themselves will be undergoing reorganization and staff reductions. The combined impact of self-finance and the wage reform will create anxiety among workers, who will be threatened with wage cuts or loss of jobs. The confusion and disarray will be exacerbated because some firms and sectors will be operating under the old rules of the game and others under new ones. 25X1

How the leadership will react if production falters or workers protest is a matter of speculation. Although General Secretary Mikhail Gorbachev has vowed to keep up the momentum of "restructuring," the leadership may elect to stretch out the schedule for implementing the present reform package, and also could acquiesce to adjustments in it that, in effect, would preserve the present modus operandi. Alternatively, it might try to force the pace of implementation, accepting a period of disruption, in the expectation that economic performance will improve markedly when the reforms are fully in place in the framework of the new five-year plan for 1991-95. Although it seems unlikely that the main parameters of the present reform package will be changed soon, Gorbachev might push through some major innovations in agriculture, in the hope of getting a quick boost in performance there; he has said that a Party plenum would be scheduled to deal with agriculture. In the long run, however, he probably will be disappointed in the results of his present package of reforms and, if his zeal continues, can be expected to push for further reform. 25X1

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Introduction

On 30 June 1987 the Supreme Soviet approved by decree a package of measures designed to alter the ways in which the Soviet economy is managed. These measures are set forth in a document, Basic Provisions for Fundamentally Reorganizing Economic Management, approved a few days earlier at a plenum of the Central Committee of the CPSU. Eleven decrees dealing with major aspects of the reform were subsequently issued by the CPSU Central Committee and the Council of Ministers.[1] The Supreme Soviet also adopted a new Law on the State Enterprise, which forms a key part of the reform package. Also included are the decrees adopted in 1986 mandating an overhaul of the entire wage and salary system, reorganizing foreign trade administration, expanding the rights and responsibilities of regional authorities, sanctioning expansion of the scope of economic activity by private individuals and producer cooperatives, as well as actions taken during 1985-87 to establish new bureaucracies, reorganize old ones, and reform incentives in agriculture. As a whole, the program provides the present official blueprint and time schedules for putting into place a "new economic mechanism" that is supposed to be almost fully operational by the start of the 13th Five-Year Plan in 1991.

This paper will describe and evaluate the changes laid out in this highly complex set of reform documents. We consider, in turn, nine major aspects of the package: the role of central planning, the position of the enterprise, the role of central administrative bodies, the system of material/technical supply, prices and wages, finance and credit, the conduct of foreign trade, private and cooperative activity, and agricultural reforms. Then we evaluate the package as a whole, focusing on the extent to which its provisions as now spelled out alter the basic features of the present economic system. We also assess the likely consequences of the concerted attempt to implement those provisions under pressure from a determined leader, which now seems likely. In a speech at Murmansk in October 1987, Gorbachev stated ". . . we have adopted the appropriate documents. They were approved by the June plenum of the party's Central Committee. . . . Now the next phase has arrived. Everything that has been decided must be implemented."

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Description of the Reform Package

The Role of Central Planning

The Basic Provisions stress that the economy is to continue to be planned and managed as "a unified national economic complex," as the principal means of carrying out the party's economic policies. These policies are to be embodied in a 15-year plan that sets goals and priorities and outlines a program for implementing them. This plan, which is to contain specific targets for the 15-year period, is to be the basis for detailed formulation of the plan for the initial five-year period, with a breakdown by years. As now, this plan will be worked out by Gosplan and sent down to republic Councils of Ministers and to ministries. These bodies, in turn, send "initial planning data" to firms, on the basis of which they work out and ratify their own five-year and annual plans. Plans are reviewed annually and revised if required. Proposals for revisions are submitted to Gosplan, which reviews them, revises the five-year plan if necessary, and submits a report to the Council of Ministers and to the Central Committee, along with the draft state budget. 25X1

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Enterprises receive: (1) "nonbinding control figures" that specify value of output, profit, foreign currency receipts, and major indicators of scientific and technical progress and social development (the list is to be

[1] Ten of the decrees have been published. One more, dealing with the work of the Council of Ministers, has yet to appear.

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fixed by the USSR Council of Ministers); (2) a mandatory bill of state orders for output that "ensure meeting society's priority needs" (the bill includes commissionings of facilities financed by state centralized investment and products required to carry out essential state tasks in the areas of social development, scientific-technical progress—including important new products—foreign economic relations, defense, and deliveries of farm products to the state); (3) allocations of rationed goods and centralized investment funds; and (4) "long-term economic normatives" [2] according to a list approved by the Council of Ministers, regulating, among other things, growth of total wages, payments for capital and labor, and the allocation of profits among various kinds of taxes and funds set up by ministries and enterprises (three major funds are the bonus fund, the social development fund, and the fund for financing research and development and investment).

Clearly, the state intends to determine the rate and direction of most investment. How much will depend on how state-centralized investment is defined. The state also intends to determine the directions of economic development and to enforce programs of scientific-technical progress that are worked out from the top. Through the system of state orders, the government will continue to dictate production and allocate the requisite materials for some part of total output, but the share of state orders in total output is supposed to gradually decline. Determining these orders is the "most important task of Gosplan," according to Premier Nikolay Ryzhkov.

Position of the Enterprise

The new Law on the State Enterprise fixes the intended status of the firm under the reforms in considerable detail. The law takes effect on 1 January 1988, and firms are to be put under its full provisions gradually during 1988 and 1989. As now, firms, which are founded and liquidated by superior bodies, are accorded legal rights of "possession, use, and disposal" of physical assets—which remain under state ownership. Firms are formally subordinate to government agencies (ministries or regional bodies). 25X1

The law, which is long on reform rhetoric and short on precise legal language, supposedly expands greatly the decisionmaking authority of the firm by providing that it "is entitled to make on its own initiative any decisions provided that they do not run counter to existing legislation." The law endows the firm with "rights whose observance is guaranteed by the state" and provides means by which the firm may obtain redress if superior organs violate such rights. The law also spells out in considerable detail the rights and obligations of the firm in a number of key areas that are the focus of the reforms and of current policy. Finally, the law explicitly makes it possible to declare bankrupt and liquidate firms that persistently make losses. Displaced workers are to be given severance pay and helped to find new jobs. 25X1 25X1

The firm is now to "independently" work out and approve its five-year and annual plans, based on "nonbinding" control figures, mandatory state orders, central allocations of materials and investment, stable economic normatives, and contracts with customers. The law states, "The enterprise is obligated to strictly observe plan discipline and meet plans and contractual obligations in full." It states further, "Fulfillment of orders and contracts serves as the most important criterion for evaluating the activities of the enterprise and providing material rewards for its employees." 25X1 Managerial bonuses are fixed by the ministry and paid out of incentive funds formed from enterprise profits; the present "Recommendations" promulgated in implementation of the general wage reform decree of September 1986 link bonuses to 100-percent fulfillment of contracts and other key plan targets and specify ceilings on amounts. 25X1

The reform documents require the firm "as a rule" to finance all of its current and capital expenditures from its sales revenues and other internally generated funds—a condition labeled "full economic accountability and self-finance." With its superior organ's

[2] For example, normatives specify the percentage of enterprise profits that must be paid into the state budget in each year. Normatives also specify the allowable growth of average wages relative to the growth of labor productivity; for example, a 0.6-percent increase in wages for each 1.0-percent increase in labor productivity.

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approval, the firm may choose one of two approaches to defining its "economically accountable income" (*khozraschetniy dokhod*):

- As the sum of the wage fund determined by normatives plus the profit remaining after payment of all taxes, obligatory contributions to ministerial funds, and payments of interest on bank credit. This residual profit is allocated via state-set normatives (percentages) to the three incentive funds—for financing investment and R&D, for financing housing and amenities for workers, and for awarding bonuses.

- As the residual that remains after deducting from total revenues the sum of material and related outlays, taxes, contributions, and interest payments. From this amount are then deducted the payments into the investment and social-cultural funds (determined as prescribed shares) to leave a single fund for remunerating labor.

The first approach is the usual practice now, but the second is a feature of the continuing wage reform in the retail trade sector. The principal difference is that in the second approach all of a worker's income depends on the firm's profits, whereas only bonuses depend on profits under the first method. The firm can decide for itself how to spend the money in its three funds, within the limits on their use specified in various inplementing documents. 25X1

Furthering Gorbachev's call for "more democracy," the new Law on the State Enterprise, amending the 1983 Law on the Labor Collective, provides for elected enterprise labor councils and elections of key managerial personnel. The council, which must meet at least every quarter, is elected by the work force by secret or open ballot for two- or three-year terms. No more than one-fourth of the members may be representatives of management. The council is empowered to decide a variety of matters relating to the use of the enterprise incentive funds and to the pay, discipline, and training of the work force; its decisions are binding on both the administration and the work force. According to the new law, "enterprise managers, heads of divisions of associations, production units, shops, departments, sections, livestock units and links, as well as . . . foremen and brigade leaders" are to be elected by the appropriate work force. Enterprise managers are elected "as a rule on a competitive basis" at a general meeting of the collective by secret or open ballot for a five-year term, and the selection must be ratified by the appropriate superior organ. Managers may be removed by vote of the collective. Heads of associations are to be elected at a conference of representatives of labor collectives of components. The procedure for electing leaders of lower level bodies is the same, except that election results are ratified by the enterprise manager. The Basic Provisions recommend that work collectives set up councils and elect leaders in 1987 and 1988. 25X1

The Role of Central and Regional Administrative Bodies

The reform documents make clear the leadership's intent to carry out a major shakeup of the central and regional bureaucracies—revising their functions, reorganizing their structures, and cutting their staffs. According to Premier Ryzhkov, all this is to take place in 1987 and 1988. ***Gosplan's*** staff is to be reorganized to deemphasize sectoral subdivisions in favor of "economic complexes," such as "machine building," "energy," and "social development." Gosplan is supposed to concentrate on long-range strategic planning and development of methods for managing the economy primarily through "economic levers"—long-term plans and normatives, prices, and financial and credit policy. More specifically, Gosplan is supposed to coordinate the work of all central bodies dealing with the economy, work out five-year and 15-year plans and transmit them to executants, determine the composition of state orders, and compile material balances and plans of distribution "for the most important types of output." The ***State Committee for Science and Technology*** is also to be reorganized to carry out its main functions: working out state scientific and technical (S&T) programs; formation, distribution, and monitoring of the bill of state orders for development of such programs; and guiding the work of intersectoral S&T complexes, whose role is to be expanded. 25X1

Superministries. These bodies, which are directly under the USSR Council of Ministers, oversee groups of related economic activities and are an ingredient of Gorbachev's reform package. Each superministry has several ministries under its aegis and can reallocate investment among them. Seven superministries were set up during 1985-87: State Committee for the Agroindustrial Complex, State Committee for Construction, State Foreign Economic Commission, Bureau for Machinebuilding, Bureau for the Fuel and Energy Complex, Bureau for the Chemical and Timber Complex, and Bureau for Social Development. The authority of these organizations has not yet been spelled out. The Basic Provisions merely call for improving the work of such bodies and focusing it on "the tasks of carrying out a radical reform of economic management."

Ministries. The ministries are to be reorganized to gradually eliminate sectoral subbranches (*glavki*) and to reduce staffs. In place of the *glavki*, the new scheme is to have "several thousand" large units directly subordinated to the ministries; this is to be accomplished by continuing the process of amalgamating enterprises into production and science-production associations and by creating new groupings called state production associations, which are supposed to be intersectoral and to integrate all phases of the research-production-marketing chain. Heavy industry is to be managed by all-union ministries. In late 1987, the union-republic ministries of Coal, Power and Electrification, Ferrous Metallurgy, Nonferrous Metallurgy, Geology, and Petroleum Refining and Petrochemical Industry were transformed into all-union ministries. The internal reorganization of the ministries is supposed to be completed by the end of 1988.

While supposedly being relieved of the functions of day-to-day control over firms, the ministries are still given enormous responsibility. According to the Basic Provisions, the ministry "is responsible to the nation for satisfying demand for the branch's product, preventing disproportions, ensuring that the product meets world technical and quality standards, and developing and implementing branch S&T programs." As now, it serves as an intermediate level in the planning and administrative process. While it is enjoined to strictly observe enterprise rights as set forth in the new Law on the State Enterprise, that law and the decree on the ministries make clear the large role that the ministry is expected to play vis-a-vis subordinate associations and enterprises. Specifically, the ministry is directed to "counter monopolistic tendencies of firms and to take measures to prevent inflation in costs and prices, stagnation in scientific and technical progress, and restriction of production of goods in demand." Ministries set up centralized reserve funds financed by deductions from enterprise profits and used to fund ministerial staffs and aid subordinate firms. They establish and liquidate firms, monitor and conduct annual audits of enterprise activities and may guarantee the bank loans of firms in trouble, underwrite the expenses of planned-loss firms while working out means to make them profitable, and help out firms temporarily short of cash. 25X1
Ministries also define control figures, state orders, limits, and economic normatives for each firm or association; "ensure" that the five-year and annual plans drafted by enterprises are coordinated and consistent; ratify appointment and dismissal of elected firm directors and administer the awarding of bonuses to them; and interact with central and local bodies in carrying out a variety of activities for which all are held mutually responsible. 25X1

Regional Bodies. The Basic Provisions (and the decrees of July 1986 and July 1987) convey the intent to accord the republic Councils of Ministers and their subordinate bodies, notably the local Soviets, a greater role and responsibility for regional economies, especially those aspects relating to the welfare of local populations. These bodies, too, are supposed to be reorganized to improve administration; thus, new "production-economic departments" are to be set up under local Soviets and other regional bodies. Specifically, the Basic Provisions call for: concentrating the administration of enterprises that primarily serve local markets in republic and local bodies; working out 15-year plans for the economic and social development of regions; distributing centralized investment among sectors and ensuring that allocations for social development depend on the overall economic performance of regions; and channeling more funds into local budgets through taxes on the profits of local

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enterprises while giving more autonomy over their budgets to local authorities. The Basic Provisions make republic Councils of Ministers and their subunits responsible for coordinating the activities of all enterprises located on their territory with respect to provision of goods and services for the populations, seeing to it that all local enterprises participate actively and cooperate fully with the local Soviets in their endeavors on behalf of the local populace, and requiring the local Soviets to monitor such enterprise activity.

The Supply System

The Basic Provisions call for a "decisive transition from centralized allocation of material resources and the attachment of users to producers" to "wholesale trade in the means of production," to be completed in four to five years. The decree on the State Committee for Material and Technical Supply (Gossnab) charges that body with the task of organizing wholesale trade. The process is to start with "groups of goods of greatest importance for consumer goods production, agriculture, construction, machinery production, and the needs of cooperatives and private producers." Only "particularly scarce" goods will continue to be rationed, but the list includes the allocation of inputs that are required to fulfill mandatory state orders. Wholesale trade, which is to become the main form of supply, is to take the form of "free" purchase and sale under direct contracts between enterprises or with state wholesale organizations, primarily regional bodies, and with manufacturers' direct outlets. Regional units of Gossnab are to play the major role in organizing supply. The Law on the State Enterprise gives firms the "preferential right" to retain present arrangements, expand long-term direct ties, and select the form of supply. That law, along with existing decrees on product deliveries and contract law, extensively regulates the mutual responsibilities of parties under contracts. Early in 1987, the Supreme Court adopted a law that strengthens the system for settling contract disputes by transferring the State Board of Arbitration from the jurisdiction of the Council of Ministers to the jurisdiction of the court system.

According to Ryzhkov, only 5 percent of Gossnab's total deliveries consists of genuine wholesale trade at present, presumably the sales of several hundred wholesale stores in cities and recently permitted unfunded purchases by a variety of small-scale users. A Council of Ministers decree adopted on 17 July 1987 instructs Gossnab to bring the share of wholesale trade in total supply to 60 percent by 1990 and to "complete the transfer" by 1992. That percentage apparently refers to the activities of Gossnab. Other supply networks exist in the agroindustrial complex, in the State Committee for Supply of Petroleum Products, and in the separate supply networks of many ministries. At present, Gossnab sales account for 80 percent of all industrial production that is sold through trading organizations. Gossnab officials have recently indicated that in 1992 wholesale trade will comprise 75 to 80 percent of Gossnab sales and two-thirds of total sales. These officials have stated that wholesale trade will not include electricity, crude oil, gas, metal ores, rolled metal, various kinds of specialized equipment, and products supplied for export, defense, and "market stocks" (presumably grain).

Prices and Wages

Prices. The Basic Provisions call for a "radical" reform of prices to be completed by 1990, so that the new prices can be used in developing the 1991-95 plan. Specifically, the decree on price formation states that revised industrial wholesale prices and tariff rates in transportation and communications are to take effect on 1 January 1990, and new construction and agricultural procurement prices are to be introduced on 1 January 1991. No date was set for introduction of new retail prices, except that the price reform as a whole is supposed to be completed by 1991. Unlike its predecessors, this reform is to encompass all forms of prices—wholesale, procurement, and retail prices and rates, with changes in the various sets of prices to be interconnected. Centrally set prices, the share of which is to be "sharply reduced," are to be determined as part of plan formation and fixed on the basis of "socially necessary expenses of production and sale, utility, quality, and effective demand." They are to take into account the charges for natural resources, capital, and labor that enterprises will now be required to pay and the costs of environmental protection. They also will have to incorporate the new amortization rates to take effect on 1 January 1988.

More specifically, prices of fuels and raw materials are to be raised sharply to ensure "normal profitability" for those branches, and some machinery prices are to be reduced. Contract prices and those set independently by enterprises are to become more common and are to be set on the same basic principles as state-set prices. Those principles and procedures are to be laid down, and all prices closely monitored, by state organs—mainly the State Committee for Prices, whose membership now includes representatives of Gosplan, the Ministry of Finance, the State Committee for Statistics, and the Central Council of Trade Unions. The Basic Provisions call for establishing "a single state system of price control."

The sensitive issue of revising retail prices to conform to the new pricing formula is addressed by calling for a broad public discussion of the price reforms and by stating that changes in retail prices "not only must not reduce living standards of workers, but also must raise them for some groups and more fully promote social justice." At present, some foods and some services are heavily subsidized, costing the state budget 73 billion rubles. Alcoholic beverages, clothing, many durables, and luxury goods are heavily taxed.

Wages. The Basic Provisions incorporate as an essential ingredient of the package the major overhaul of the entire wage and salary structure in the production sectors; this change was launched by decree of the CPSU and the Council of Ministers in September 1986. The wage reform is to be carried out branch by branch and firm by firm during 1987-90. To implement the decree, two lengthy sets of "Recommendations" have been issued under the joint imprimatur of the State Committee for Labor and Social Problems and the All-Union Central Council of Trade Unions. Differentiated by sector and branch of the economy, this pay reform establishes new labor grade structures and base rates for production workers, with base rates being raised by an average of 20 to 25 percent; provides for a review of existing assignments of jobs to labor grades and of individuals' assignments to jobs; mandates a revision of work norms and piece rates to make them more "progressive"; and establishes new salary scales for white-collar workers, raising the average salary rate by 30 to 35 percent. The reform also gives enterprise managers a variety of options for adjusting job rates and awarding bonuses to encourage efficiency and to ensure that each worker's earnings accord with his productivity, and specifies that the reform is to be put into effect in each firm whenever its ministry determines that it can finance any resulting increases in average wages within the limits of the allowed wage fund and some transfers from the bonus fund financed from profits. The Law on the State Enterprise broadens the rights of directors in matters of labor and wages, in collaboration with the enterprise trade union and the Labor Council. It also specifies, as do the Basic Provisions, that no ceiling shall be put on individual earnings. But the size and growth of the total wage and bonus funds are regulated by various ministry-set normatives.

The intent of this sweeping reform of the pay system is to raise the role of job rates in workers' earnings (to 70 to 75 percent compared with 50 to 60 percent at present), make bonuses harder to get and more closely dependent on the efficiency and quality of performance of both the worker and the firm, tighten work norms (which were regularly being overfulfilled by large margins), and contribute to more general reform objectives of enforcing self-finance, eradicating "wage-leveling," and encouraging work effort and acquisition of skills by the work force.

Finance and Credit

This section of the Basic Provisions mainly demands that the banks and other financial agencies promote the effective implementation of the principle of self-finance by enterprises. Separate decrees spell out the role of the banks and the Ministry of Finance. These agencies are told to put the country's financial house in order by ceasing inflationary practices such as printing money to back up bank credit. More specifically, as in past reforms, bank credits and interest rates are to serve as important economic levers in promoting efficient use of resources in enterprises, and bank credits are to become a more important source of financing investment. The banking system has been reorganized to create six major banks—instead of three as now. The six banks are: State Bank; Industrial Investment Bank; Bank for the

Agroindustrial Complex; Bank for Housing, Municipal Services, and Social Development; Savings Bank; and Foreign Trade Bank. Banks and insurance agencies are supposed to operate on the principles of economic accountability and self-finance. Budget-supported institutions are to be provided with incentives to become more efficient. Finally, enterprise payments for resources are to provide the main source of budget revenues from public-sector activities. Although highly differentiated now, these charges ultimately are supposed to be uniform for all enterprises and sectors.

Foreign Trade

Gorbachev's reform package includes an overhaul of the system for conducting foreign trade. A joint CPSU–Council of Ministers decree adopted in August 1986 established the State Foreign Economic Commission as a superministry overseeing all facets of foreign economic activity and reorganized the Ministry of Foreign Trade to end its monopoly over trade by transferring some of its Foreign Trade Associations to the jurisdiction of ministries and other central bodies. On 1 January 1987 some 20 ministries and other bodies and 70 selected enterprises were granted the right to engage directly in importing and exporting activity with appropriate units in foreign countries. The decree also directed that foreign currency funds be established in exporting enterprises and associations to finance machinery and equipment imports, gave enterprises extensive rights to engage in joint projects with firms in other member countries of the Council for Mutual Economic Assistance (CEMA), and sanctioned joint ventures with firms in capitalist countries. Subsequently, regulations were issued detailing procedures for carrying out such joint projects.

The Basic Provisions do not include additional foreign trade reforms; they merely call for greater use of financial-credit levers in promoting the expansion and efficient conduct of foreign trade. They do set a goal for "stage-by-stage" convertibility of the ruble, starting with the CEMA trading system. The Law on the Enterprise, however, contains a lengthy new section on foreign economic relations, which details the rights accorded by the earlier decree to individual firms in the realm of foreign trade. The emphasis is on developing exports and on arranging mutually beneficial ventures with socialist countries. The firm has the right to keep part (determined by long-term normatives) of the foreign currency earned from exports to purchase goods from abroad and is held responsible for the "rational" use of such funds. Higher authorities are forbidden to confiscate unused funds. It seems, however, that firms cannot participate directly in foreign economic activity without the sanction of some higher body, presumably a ministry. 25X1

Private and Cooperative Economic Activity 25X1

The documents from the June plenum strongly endorse reform measures adopted in 1986 that aim to expand the role of producer cooperatives and private individuals in the economy, particularly in the provision of consumer goods and services. As part of a crackdown on corruption and illegal private economic pursuits, a Supreme Soviet decree adopted in May 1986 sets stiff new penalties for failure to comply with existing laws concerning permissible private activity. A law adopted in November 1986 and effective 1 May 1987 spells out the kinds of permissible endeavors and the groups that are to be encouraged to engage in them (state employees only outside working hours, pensioners, housewives, and the handicapped). Subsequently, the high tax rates on income from private work were reduced somewhat. In August 1986, the Politburo approved some "basic principles for development of cooperative forms of production." They specify that producer cooperatives are to be organized on a voluntary basis "with the participation of ministries, departments, and local Soviets." Subsequently, the Council of Ministers promulgated decrees and model charters for cooperatives that collect and process waste materials, produce and market consumer goods, and provide services. The decrees on expanding the rights of local Soviets and other regional bodies give them the major role in developing and regulating cooperative and private businesses. 25X1

Agricultural Reforms 25X1

Besides endorsing the 1982 Food Program, Gorbachev has spelled out his recipe for agricultural reform in two major decrees. The first, adopted in November 1985, established the State Agroindustrial Committee

(Gosagroprom), a superministry to manage the production, marketing, and processing of farm products. It was formed as a merger of five ministries and a state committee, but agencies in charge of grain production and land reclamation remain independent. This reorganization also was intended to strengthen the position of the regional agricultural production associations (RAPOs) that had been set up at various local levels as part of the 1982 Food Program. The second decree, adopted in March 1986, was directed toward increasing the autonomy of farms and improving incentives. The principal provisions of this complex and ambiguous decree are to permit farms to sell at market prices a larger share of production, to introduce measures to market farm products more flexibly, to extend to farms many of the arrangements now being applied in the industrial sector (such as normative planning and self-finance), and to endorse the widespread use of collective contracts. Gosagroprom was instructed to develop further proposals for improving agricultural management in preparation for drafting the plan for 1991-95. [redacted]

The Basic Provisions and the Law on the State Enterprise apply in general to agriculture. Although there are few specific references to that sector in these documents, Gorbachev addressed agricultural matters at some length in his speech to the June plenum. He stated that the measures already effected had created the potential for a breakthrough in farm output. He strongly endorsed the use of collective contracts, especially brigades using intensive technology and family groups. In late September, a CPSU Central Committee resolution demanded that all production units adopt contractual forms of labor organization in 1988 and that all agricultural organizations be transferred to full economic accountability and self-finance during 1988 and 1989. Finally, Gorbachev has announced that agriculture is to be the subject of discussion at a coming party plenum. [redacted]

Evaluation of the Reforms

The Schedule for Implementation

Gorbachev is a man in a hurry. His program of reform, far more than its predecessors, imposes a staggering set of tasks on the central bureaucracies and on the producing units to be accomplished in the next three years. At its meeting on 17 July 1987 the USSR Council of Ministers excoriated one and all for not moving fast enough on all fronts and imposed some specific tasks and deadlines. The leadership has made it clear that all this is to be done by everybody, while simultaneously guaranteeing fulfillment of the demanding plan targets for 1987, 1988, and 1986-90. [redacted] 25X1

Gosplan, while undergoing an internal reorganization, has been required to work out the 1988 and 1989 plans for firms and sectors operating under both the new and the old conditions and must begin formulating the plan for 1991-95 in the reformed format. Two sets of planning and reporting documents will have to be devised for 1988-90 and standard sets worked out for 1991-95. One such instruction (on the plan for 1988) was approved in April 1987 and had to be revised. Gosplan also will have to fix the annual bill of state orders to be handed down to ministries and republic councils of ministers. According to a Gosplan official, such orders in 1988 will account for 90 25X1
percent of the output of the fuels ministries, 60 percent of that of the civilian machinery ministries, 30 groups of chemical and petrochemical products, and 12 kinds of consumer durables. Gosplan will continue to work out material balances and distribution plans for 415 major products. [redacted] 25X1

Gossnab must cope with the inevitable confusion that will ensue from the dual system, whereby state orders and "freely negotiated" contracts with customers and suppliers will be in effect for many firms and the old modus operandi in effect for others. As noted earlier, the Council of Ministers has instructed Gossnab to raise the share of "wholesale trade" in the total volume of its sales to 60 percent by 1990. Gossnab's role is slated to increase, however, because according to its chairman the wholesale trade market "is not spontaneous, but organized." The agency will also 25X1
take over from Gosplan the task of compiling material balances and plans of distribution for over 1,500 key products. [redacted] 25X1

Goskomtsen, while meeting its present responsibilities and reorganizing its staff structure, must prepare an overhaul of the entire system of state-set prices and rates, ensuring that changes in the various sets of prices—wholesale, procurement, retail—are linked together. It must publish lists of the new centrally set prices, prepare instructions for setting contract price and prices set independently by enterprises, and develop a "unified" system for monitoring all prices. This herculean task is to be completed in time for the new prices to be used in the 1991-95 plan. Since all financial plans depend on these prices, the plan and the reform-related five-year "stable" normatives cannot be worked out without them.

Those ***ministries*** wholly or partially under self-finance in 1988 will have to plan and conduct their affairs under the new definitions and procedures. Numerous instructions must be formulated to guide enterprises. To carry out the new rules of the game, the ministries will have to define the bill of state orders and establish the many normatives for each enterprise and association individually, because they operate under widely varying conditions. Ministries will have to implement the overhaul of wages and salaries by determining when each firm is financially ready to effect it. Simultaneously, they will have to figure out how to manage their branches under the nebulous conditions imposed by the Law on the State Enterprise. The minister is held "personally responsible" for expeditious implementation of everything connected with the new order of things, while also being accountable for the current production activities of the branch. Ministries must also amalgamate associations and enterprises into new "state production associations," while reorganizing their own internal structures and reducing staffs and while under constant threat of being abolished, split, or joined with another agency. Already, four machinery ministries have been merged into two ministries and two state committees into one, and six union-republic ministries have been converted to all-union status.

The situation confronting ***regional bodies*** is similar to that facing the central ministries. They must handle the new rules of the game for subordinate firms, cope with the new tasks imposed on them, and devise schemes for reorganizing their administrative structures. The USSR Council of Ministers has instructed the republic Councils of Ministers to submit such reorganization plans.

While ***enterprises*** struggle to carry out the many production and investment tasks imposed by the plans and the new state quality inspectors, they must figure out how to cope with the intricate new rules of the game that the Law on the State Enterprise imposes on them, with the details of the wage reform, and with the ubiquitous monitors (especially political bodies) determined to see to it that "priority" matters are attended to with dispatch. Enterprises will be under pressure to set up Labor Councils and to conduct elections of key managerial officials. The electoral process may well create uncertainty and anxiety among managers and produce considerable turnover in their ranks. Potentially the most disruptive facet of the reforms is the schedule for imposing conditions of full self-finance on enterprises. In 1987, those rules of the game affected all firms in five industrial ministries and 37 entities in various others; all together they represent over 20 percent of total industrial output and 16 percent of employment. According to Premier Ryzhkov, self-financed enterprises will account for 60 percent of industrial output in 1988, when the new conditions will also apply to all branches of transportation and a number of other sectors. The process is supposed to be completed in 1989. The new rules already are creating many problems for firms, according to press accounts.

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The Package as a Whole

Taken as a whole, the package of reform measures introduced during Gorbachev's two and a half years of tenure is impressive. It is comprehensive, embracing nearly every major aspect and sector of the economy. But a major gap in both the 1965 and the present package of reforms is the failure to provide a mechanism for more efficient allocation of investment among firms and across sectors—a problem that has proved crucial in the reform process in Hungary and Yugoslavia. Although the subjects they address and the direction they take are similar to those of the 1965 reforms, Gorbachev's reforms add to the major areas addressed in 1965: an overhaul of the wage and salary system, a reform of the administration of foreign trade, measures to expand cooperative and private economic activity, and provisions for election of enterprise Labor Councils and key managerial personnel

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by the work force. Unlike its predecessors, his package spells out the intended reform objectives in fairly explicit terms and outlines the measures to achieve them, while setting tight schedules for their implementation.

But one is hard pressed to visualize the nature of the economic system that the framers of this package intend to install, a package variously described as "radical," "revolutionary," and based on the principle of "more socialism, more democracy." Its present overall design is not that required to install a system of market socialism or of worker self-management as those terms are usually understood. Despite many allusions to creating autonomous, competing, self-managed business firms, the reforms do not go nearly far enough to create a market environment as Lenin did in 1921 with his New Economic Policy, nor do they allow workers to make the key decisions that determine the outcomes of the firm's activity, as they do in Yugoslavia. Gorbachev's reform decrees leave the pillars of the traditional economic system prominently in place—state ownership, central planning (albeit changed in form and reduced in detail), numerous administrative agencies overseeing the activities of firms, rationing of many materials and investment goods, state control over price setting, and enterprise incentives still oriented toward plans and output targets and biased toward dealing with administrative superiors rather than following the signals from markets.

Moreover, the package as now spelled out in the relevant laws and decrees contains inconsistencies and contradictions that, if not resolved, will seriously limit its effectiveness. These problems with the design of the reform will be reinforced by some specific policies being pursued simultaneously with the implementation of the reforms. Thus, as of now:

- Ministries and regional bodies are held responsible for production results in their respective areas and for ensuring that subordinate firms act "properly," while simultaneously being instructed not to interfere in enterprise decisionmaking.

- Through the mechanism of self-financing, firms are expected to operate efficiently (to produce goods in demand at least cost), but the price and profit signals needed to assess the trade-offs are not likely to be provided by the reform of the pricing process being heatedly debated. 25X1

- The Law of the State Enterprise accords enterprises wide latitude in decisionmaking, but also saddles them with many center-inspired recipes and expectations—for example, to introduce multiple shifts, set up brigades, produce a quota of consumer goods and services, establish subsidiary farms, and actively support an expansion of private and cooperative activity.

- The reforms explicitly require stability (for five years) in a variety of parameters, whereas flexibility is needed to establish markets and make them work effectively.

- While inveighing against monopolistic tendencies, the reforms entail an increase in the already extreme degree of concentration of economic activity in large amalgamations. 25X1

Key Parts of the Package

Central Planning and Management. While calling for much greater reliance on "economic levers," such as prices, bank credits, and interest rates, the policy statements and specific provisions of the reform program make it clear that a large degree of central management of the economy is being retained. They display the traditional conviction that economic development—the composition of output and the allocation of investment as well as the broad content and direction of scientific technological progress—must be managed by the center. The framework of mandatory, "stable" five-year plans is retained, along with numerous new and old government bodies to help to formulate them and monitor their implementation. New forms of central management—supposedly

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"nonbinding" control figures, state orders and "voluntary" contracts, and long-term, stable normatives—replace the familiar categories. That the center is to slough off a mass of detail is of secondary importance to the fact that the domain of central administration is still so great. Moreover, the central bureaucracies will now have to cope with the confusion and unintended results that will arise in implementing the new rules of the game. [redacted]

The Position of the Enterprise. The business firm remains subordinate to government agencies, which are to eschew "petty tutelage," while ensuring that the sector's output goals are met and that the firm behaves "properly." Absence of "petty tutelage," if it eventuates, may reduce the frustration of managers of firms, but ministerial micromanagement, which is often blamed for all sorts of malfunctions, has been a minor factor in the past difficulties of the economy. On the contrary, under the new arrangements the firm is likely to be eager to have ministerial aid, particularly with respect to the determination of the many normatives that undoubtedly will provide a fertile field for bargaining. While being pushed to "freely" negotiate contracts for much of its output with customers and for the requisite raw materials and capital goods with suppliers in a framework of competition, the firm will find that the information and infrastructure needed to support competitive sales and purchases is almost totally lacking. A rational (and likely) response would be to seek to have as much as possible of its product classified as "state orders" backed up with rationed inputs and to sign long-term supply contracts with Gossnab for nonrationed goods. [redacted]

Meanwhile, portions of the enterprise's products and its raw materials will have rigid state-set prices as now, and the prices it may set or negotiate necessarily must take them into account along with methodological guidelines. Even its independently set prices are subject to strict state monitoring. The manager's bonus depends on meeting (planned) contracts for output (little different under universal contracting from gross value of output or sales) and on indicators for several other aspects of performance. Finally, the new deal provides the firm with still another participant in decisionmaking and monitoring—the Labor Council—and subjects key managers to the elective process. [redacted] 25X1

Since all of this does not create a competitive market environment, the enterprise is likely to remain basically risk-averse and center-oriented. Although the vision (figuring prominently in the reforms) of autonomous, 25X1 self-financing, socialist business firms threatened with bankruptcy for failure conveys an aura of markets and competition, its reality in practice is an artificial accounting construct, both under present Soviet conditions and under those created by the reforms. Because prices of products and material inputs do not (and will not even with the upcoming revisions) reflect the real economic trade-offs, the derivative accounting categories of sales, costs, profits, and returns to capital can be misleading. Managerial decisions based on them do not necessarily result in efficient mixes of inputs and outputs, profits do not indicate relative efficiencies of firms, and failure to earn profits and thus to go bankrupt need not mean that the firm was inefficient. The expectation that large gains in efficiency will accrue from enforcing self-finance is therefore unlikely to be realized. [redacted] 25X1

Supply. Along with its call for a "resolute" shift of most purchases and sales of intermediate and capital goods from central rationing to "free" wholesale trade between buyers and sellers, the Basic Provisions accord Gossnab the key role in the process. The Law on the State Enterprise instructs the firm to arrange for nonrationed supplies "first of all" via contracts with regional divisions of Gossnab. How is this process 25X1 likely to work out in practice? Contracting is already widespread: [redacted] in most 25X1 branches of industry 80 to 90 percent or more of total deliveries are now accomplished through formal contracts, the bulk of them with Gossnab units. Five-year contracts (termed "long-term direct ties") have been encouraged and are widely prevalent: in 1986, they made up 30 percent of total Gossnab sales. Faced with the need to nail down through contracts their "independently" planned sales and purchases, firms in the near term, aided and abetted by Gossnab, can be expected to scramble to keep existing arrangements and tie up new ones. These arrangements, by and large, are likely to form the basis in the 13th Five-Year Plan for the contracts on which the firms are required to base their plans. All this will make for rigidity and inhibit the competition among firms that the reforms aspire to develop. It certainly does not create a market for raw materials and capital goods. [redacted]

Even so, the pressure to deration goods and enhance the role of wholesale trade organizations should bring some benefits. Above all, elimination of the need for ration coupons will reduce the amount of time and paperwork required to arrange sales and purchases. The drive to shift stocks from enterprise inventories to wholesale bases and to expand manufacturers' direct outlets will make supply more flexible. The process should also benefit to the extent that firms use their greater authority to sell above-plan output and unneeded inventory and equipment. [redacted]

Prices. Flexible prices that reflect supply and demand reasonably well are crucial to the success of reforms that accord financial autonomy to enterprises. Yet, according to the Basic Provisions and the decree on price reform, the principles on which state-fixed prices are to be set are similar to those used to guide the price fixers in past price reforms. The documents do call for greater attention to be paid to such factors as utility, quality, and effective demand. Although contract prices are to be set by agreement of the parties, they will be heavily influenced by such state-set prices. Contract prices are to be based on so-called base prices, which may be taken from state price lists, state-set limit prices on new products, and prices on "normative-parametric" price lists. The requirement that state-set prices remain stable for five years and that contract prices be embodied in planned contracts preserves the rigidities now prevailing. Although the intended revision of industrial and procurement prices will bring them once more in line with costs and newly imposed charges for resources, prices will remain poor guides to efficient choice. The removal of producer price subsidies, however, is a rational step toward more efficient use of inputs. [redacted]

Widespread use of contract prices and prices independently set by firms is likely to produce inflation, unless hard budget constraints are imposed on the firms. But the reforms as now designed include provisions, such as ministerial reserve funds, that could soften the constraints supposedly imposed on firms by the requirements of self-finance. Clearly, the government is concerned about the inflation potential and intends to monitor contract prices closely, an activity that will require detailed examinations of the books of individual firms. Finally, the declared intent to link the three sets of prices—wholesale, procurement, and retail—involves coming to grips with a major political-economic policy dilemma of what to do about the existing large subsidies on food and some services for consumers. Press debate over this issue is gaining momentum, and we shall have to wait to see what political will can be mustered. [redacted]

Incentives. Unlike its predecessor, this round of reforms includes a complete overhaul of the wage and salary structure and of work norms. It also installs new procedures for forming and using the enterprise bonus fund. That fund will now depend on its initial size in the base year and on subsequent changes in it that will be determined mainly by the level of profits and the fixed percentage (normative) share of profits designated for that fund. To effect the wage reform, the firm must be able to finance the higher rates out of wage and bonus funds that are determined by standard procedures (more normatives). While the timing of the installation of the new scales is supposed to be discretionary with the firm—depending on when it can finance them—considerable pressure is being put on firms to do so with dispatch, and layoffs, wage cuts, and morale problems are already arising. [redacted]

The overhaul of wages and work norms could prove to be highly unpopular. Unlike its predecessor in the early 1960s, which offered a large carrot in the form of a reduction in the workweek from 46 to 41 hours, the current wage reform offers no carrot to rank-and-file production workers. Although their base rates will be increased, with the greatest raises going to the more skilled, work norms will be tightened accordingly. Blue-collar workers will bear the brunt of layoffs

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and of the pressure to redefine and combine jobs and work night shifts. Thus, this reform package, unlike that of 1965, directly and immediately threatens both the job and the pay of every production worker. At the same time, ordinary workers will see the salaries of white-collar workers increase sharply and their total earnings rise even more, since bonuses are determined as percentages of base salaries. The lion's share of wage increases planned for 1986-90 (15 percent) will accrue to white-collar workers, who make up about one-fifth of the total in the productive sectors. Blue-collar workers, long nurtured on egalitarian values, may well consider those developments to be unfair, even though wider differentials may be needed to improve incentives.

Since the wage overhaul is being carried out piecemeal and firm by firm, both between sectors and within sectors, it is likely to result in sizable differences in wages for similar jobs in the same area and thus violate the socialist principle of equal pay for equal work. Matters will be worsened by the wide variations in the size of bonus and social-cultural funds that will prevail among firms. These inequities will arise because of the highly uneven conditions under which Soviet enterprises operate as a result of factors over which they have little or no control. For example, profit rates of firms differ widely within industries and among sectors in large part because of peculiarities of price setting. Thus, prices of products are determined on the basis of branchwide average costs plus a fixed profit markup. The quality of capital stocks differs greatly because of the vagaries of past investment policy. In short, the playing field is not level.

Salaries for managerial personnel are to be raised substantially as part of the reform of wage and salary scales. In addition, managers are paid bonuses from the firm's new unified bonus fund, which depends on profits and the applicable normative. Ministries or other higher authorities administer the general rules regulating such bonuses. The latest set of rules (recommendations) preserves the worst features of the old system. They tie bonuses to meeting a plan for production (now defined as 100-percent fulfillment of contracts for deliveries), thus giving managers an incentive to avoid accepting difficult orders and to limit the production profile. They also tie bonuses to several plan indicators for labor productivity or equivalent measures and for growth of profits or reduction in costs. Bonuses are to be paid for each separate indicator, and half of the total must be paid for meeting contracts. These rules are likely to reinforce the managers' orientation toward meeting production goals, toward pleasing superiors in the administrative hierarchy, and toward avoiding risks. Moreover, a ceiling is placed on managerial earnings. Unless these compensation rules are changed radically, they will 25X1
frustrate the reform's efforts to create competitive, innovative, market-oriented enterprises.

Finance and Credit. Under the reforms, as now, budget income will come almost entirely from various levies on enterprises, with the bulk to come in the form of payments for resources. The charge on capital is retained and will continue to be highly differentiated in the near term, as will a new charge on employment to be introduced in 1988. The labor charge is slated to be 300 rubles per year for each regular worker for firms in labor deficit regions and 200 rubles per worker per year for those in labor surplus regions. The size of these payments for resources is necessarily arbitrary in the absence of market prices to establish actual returns to factors. In any case, imposition of a capital charge has proved ineffective in the USSR, according to repeated assertions of Soviet economists, and charges for capital and/or labor have not proved effective in reforms in Hungary and Yugoslavia.

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The reforms, as they did in 1965, intend to reduce the budget's role in financing investment. Until prices are changed in ways that reduce the large variability of profit levels among firms and sectors, however, the budget's share will remain large, or, alternatively, funds will have to continue to be redistributed through the ministries. They are authorized to establish reserve funds financed by deductions from enterprise profits and amortization charges in accordance with state-set normatives.

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The reforms establish six large banks, an organizational change that amounts to dividing the responsibilities of the present Gosbank and Stroybank among six agencies rather than two. This change does nothing to create a market for investment funds. In any case, it is clear that the state intends to control the sectoral allocation of investment, as it does now. Bank credits and interest rates are supposed to be used as economic levers and normatives to regulate the financial activities of firms, and the banks' role as financial watchdogs is to be stepped up. It seems doubtful that those approaches will work any better than they have in the past 20 years, when similar themes have been in vogue. [redacted]

Outlook

Although the reform programs adopted thus far under Gorbachev add up to a set of half-measures that retain the pillars of the traditional system, they could produce some positive results. The financial pressures on the enterprise will probably reduce redundant labor and gross waste of materials. Efforts to put producers more closely in touch with their suppliers and customers, aided by the recently introduced system of state inspection (*gospriyemka*), should yield better quality products. If the go-ahead for private and cooperative endeavors produces strong momentum, it will improve the lot of consumers to some degree. The greater leeway given factories and farms to dispose of their output and unneeded inputs will work mainly to that same end. Paring of government staffs and the consequent forced redistribution of labor will facilitate adjustment to slow growth in the labor force. Relatively higher wages for skilled and efficient workers should improve incentives, provided that supplies of desired consumer goods and services are made available. [redacted]

At the same time, vigorous implementation of the present reform package has the potential to create serious disruptions in the production process in the next few years. The pressure being exerted on the enterprises simultaneously to meet demanding plan targets and speed up plant modernization increases the danger. Specifically, the switch to new and unfamiliar supply arrangements may disrupt the flow of materials to firms and create bottlenecks. Changes in the way producer goods are obtained could disrupt the investment process. Imposition of self-finance will put many enterprises in severe financial straits, causing them to spend a lot of time and energy negotiating with the banks and with their superiors in the bureaucracy. Because of the vague and ambiguous language of the many relevant laws and decrees, the relationships between enterprises and their supervisory agencies will be confused, a situation hardly conducive to speedy decisionmaking. Matters will be made worse because these agencies themselves will be undergoing reorganization and staff reductions. The combined impact of self-finance, the wage reform, and elections 25X1
of managers surely will create anxiety among workers, threatened with wage cuts or loss of jobs, and among managers, threatened with loss of bonuses or being voted out of their jobs. The confusion and disarray will be exacerbated because some firms and sectors will be operating under the old rules of the game and others under new ones. [redacted] 25X1

How the leadership will react if production falters or workers protest is a matter of speculation. Although Gorbachev has warned that the next few years will be "very difficult," he has vowed to keep up the momentum of "restructuring." Nevertheless, the leadership may elect to stretch out the schedule for implementing the present reform package; Party Secretary Ligachev has already warned of the perils of undue haste. In so doing, it could also acquiesce to adjustments that would, in effect, preserve the essence of the present modus operandi. Gorbachev has already shown a willingness to use administrative methods to resolve problems, as exemplified by the recent decrees mandating state inspection of output, multiple shifts, and inventory reductions. Or he may opt to try to muddle through a period of disruption, in the expectation that economic performance will improve marked- 25X1
ly when the reforms are fully in place in the framework of the new five-year plan for 1991-95. While it seems unlikely that the main parameters of the present reform package will be changed soon, Gorbachev might push through some major innovations in agriculture, in the hope of realizing a quick boost in its performance. He has stated that a forthcoming plenum is to be devoted to agriculture. [redacted] 25X1

In the long run, we believe Gorbachev will be disappointed with the results of the present package of reforms, which do not go nearly far enough to achieve his ambition to create a dynamic, self-regulating "economic mechanism" capable of closing the technological gap with the West. To achieve a breakthrough in technological progress, the leadership will have to make radical changes in the present reform package. If the benefits of a market economy are to be had, markets must be created by getting rid of the elements of central planning still in place; freeing enterprises from subordination to government bureaucracies and forcing them to produce in accord with market forces; providing the requisite price and profit signals by allowing prices to be flexible and to more fully reflect supply and demand; creating a competitive environment by breaking up the present huge amalgamations and permitting competition from abroad; and introducing financial and capital markets. These are the lessons learned by Hungary in its 20-year effort to reform its centrally planned economy. Whether any Soviet leadership will turn to such truly radical reforms remains in doubt. 25X1