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Soviet Economic Reforms: An Interim Report Card

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A Research Paper

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Soviet Economic Reforms: An Interim Report Card [Redacted]

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A Research Paper

This paper was prepared by [Redacted]
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**Soviet Economic Reforms:
An Interim Report Card**

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Summary

*Information available
as of 1 June 1988
was used in this report.*

The reforms adopted at last June's Central Committee plenum and introduced on a large scale on 1 January 1988 are having a rough start. The leadership has indicated its deep concern, and reform economists are pessimistic that the original intent of the reforms can survive intact.

Although the reform blueprint was bold and comprehensive, implementation of the reforms under way and articulation of the reforms that remain to be implemented have been halting and piecemeal. The heavy hand of the planning and ministerial bureaucracies still hangs over enterprise decisionmaking:

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- *Planning Reforms.* Control figures and state orders, designed to be less intrusive than the previous system of centrally dictated planning directives, in practice allow little room for enterprise autonomy.
- *Self-financing.* Continued juggling of enterprise funds by the ministries from the strong to the weak, difficulties in spending enterprise funds, and the inability to use profitability as a test of efficiency (because of the distorted price structure) make self-financing still an elusive goal.
- *Wholesale Trade.* The existence of many monopoly producers and the lack of a rational wholesale price system make the Soviets reluctant to implement wholesale trade reform, scheduled to be completed over the next four to five years.
- *Banking Reform.* The ability to apply economic criteria to banking operations depends to a large extent on the success of other reforms; therefore, Gosbank will retain strong central controls over lending criteria, bankruptcy proceedings, and interest rates for now.
- *Price Reform.* Although it is the linchpin of economic restructuring, price reform will be one of the last reforms implemented. It is divided into three parts:
 - Wholesale prices. Still in the planning stage, the emphasis appears to be on price revision rather than on reform of the pricing mechanism itself, which means that these prices will remain only imperfect guides to economic decision making.
 - Procurement prices. Changes announced thus far do not alter the essential nature of the cost-based, administered system of procurement prices.

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— Retail prices. No target is set for this politically sensitive reform, and full public discussion is promised before major changes are made.

- *Foreign Trade Reform.* Increased contacts between Soviet firms and foreign traders are allowed, but enterprise independence is limited by continued central regulation of import and export prices, foreign currency exchange rates, customs tariffs, and interest rates on credit. Confusion over the reorganization of the foreign trade sector will continue to produce trade disruptions, at least in the short term.
- *Organizational Reforms.* Staff cuts and departmental reorganization have created ill-timed disruptions and widespread resentment that is likely to fuel opposition to the reform program. The larger issue of reducing the number and power of the ministries appears to be stalled.
- *Private-Sector Reforms.* Significant new legislation gives ideological legitimacy to this sector, widens the scope of its activities, and increases eligibility, but major culture-related barriers by both officials and the public remain.

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These difficulties can be traced to a common set of problems:

- The success indicators of the economic bureaucracies have not been revised adequately to change their propensity to meddle in enterprise affairs.
- Although the total reform package is comprehensive, its timetable for implementation is piecemeal, with crucial elements such as price reform scheduled last.
- The traditional focus on the fulfillment of output targets is in basic conflict with the focus on quality and innovation emphasized in the reforms.
- The necessary implementing orders that define responsibilities and the chains of command have not been issued.
- The reforms were implemented in the middle of a five-year plan, and the central authorities feel it necessary to maintain their old administrative pressures to ensure fulfillment.

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The confusion and uncertainties generated by the reforms will have a disruptive effect on economic performance, at least in the short run. They will also increase labor-management tensions; a number of reform-related strikes have already been reported. Workers are disgruntled because the

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reforms tie wages and bonuses more directly to performance and yet productivity depends on factors largely beyond the individual worker's control. So far, from the worker-consumer perspective, the reforms have meant more discipline, less job security, slower wage increases, and only the promise of an eventual payoff in terms of more consumer goods and services.

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The leadership must take effective and immediate action to get the reforms back on track or risk pushing the payback period well into the 1990s. Many Soviet economists already believe that the time for full implementation of the reforms will actually be during the 14th Five-Year Plan (1996-2000) rather than in 1991-95 as Gorbachev originally projected. Policy initiatives that would indicate the leadership recognizes the problems at the root of reform implementation would include:

- A speedup in the implementation schedule for wholesale trade reform.
- More flexibility allowed immediately in wholesale price formation.
- A relaxation of taut output targets.
- More latitude granted to the enterprise in planning its output and in distributing and spending its funds for investment and incentives.
- A substantial reduction in the ministerial apparatus.

The upcoming party conference is scheduled to discuss the progress of the reforms. Effective new initiatives announced at that forum would send a clear signal that the leadership is committed to hewing to the original intent of the reformers and realizes the serious consequences of letting the situation drift.

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Scope Note

The economic reforms that resulted from the June 1987 plenum of the party's Central Committee promised a comprehensive, integrated approach to Soviet systemic problems. The implementing legislation, however, was rife with loopholes and ambiguities-

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paper focuses on the continuing evolution of the reform package and how the Soviets are coping with translating only nebulous marching orders into a coherent set of instructions at the production-unit level.

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Since many of the reforms just began on 1 January 1988, the conclusions drawn from this analysis should be viewed as preliminary. Presumably, the Soviets will learn from their mistakes and still have the option to refine and revise the reforms to stay on the course they originally charted. On the other hand, the problems encountered thus far might reveal basic flaws in the reform concept that could derail the reform initiatives. At the very least, difficulties in this initial stage of implementation threaten to push the transition period well into the next decade, postponing the results which the leadership was hoping for during the next five-year plan (1991-95).

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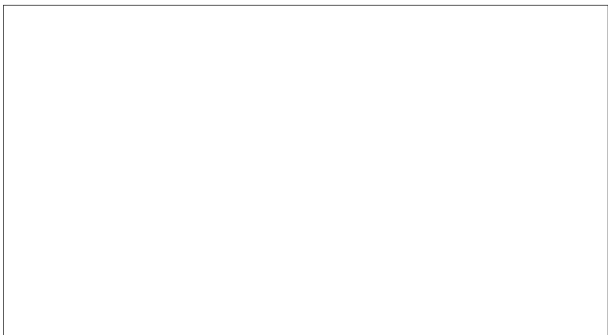
Introduction

Gorbachev, upon his accession, apparently did not have a blueprint for reform. At first he extended Andropov's and Chernenko's industrial reforms that reduced and simplified plan indicators and emphasized financing more of an enterprise's expenses out of profits. He also established a special commission to draw up reform legislation and oversee its implementation, and he sanctioned an unprecedented no-holds-barred debate on a wide range of reform-related subjects. The evolution of his thinking on this issue was finally revealed at the June 1987 Central Committee plenum, which approved guidelines for the "new economic mechanism" to be "almost fully" implemented by the start of the 13th Five-Year Plan in 1991. With the adoption of these main provisions, Gorbachev replaced his and his predecessors' piecemeal approach to reform with a comprehensive and integrated program. [Redacted]

these reforms indicates that they are off to a poor start. The leadership is worried:

- As early as November, senior party secretary Ligachev reportedly criticized Premier Ryzhkov for the Council of Ministers' failure to prepare enterprises for the switch to self-financing.
- Articles and speeches by regional party leaders indicated that they viewed the new year's reforms with trepidation.
- At the two-day Central Committee plenum in mid-February, largely devoted to educational reform, Gorbachev called on the party to fight for *perestroika* to overcome widespread worries that reforms are "being implemented slowly and with difficulties."

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The reform's "basic provisions" and the ensuing 11 decrees² were evidently the result of a compromise between those who wanted to move swiftly toward a market economy and those who preferred a more traditional approach. Their generality allows for a wide range of possible outcomes during implementation; the reforms could result in a substantial increase in enterprise autonomy and a partial dismantling of the Stalinist economic model, or potential loopholes could be used to foil this historic attempt at decentralization. [Redacted]

Reform economists also acknowledge problems in implementing reforms and in articulating those not yet scheduled for implementation. Some argue that the current ones must be scrapped, not merely modified. The reformer Boris Kurashvili, for example, proposed recently that the coming party conference authorize work to begin on a new State Enterprise Law because of major flaws in the one introduced last

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On 1 January 1988 implementation of many of the reforms began (see table). An examination of progress in the preparation for and initial implementation of

² Only 10 decrees were published; the one remaining decree reportedly deals with the reorganization of the ministerial structure. [Redacted]

Timetable of Soviet Economic Reforms

Reforms	1988 Goals	Final Objective
Self-financing	60 percent of all industrial production; 40 percent of all enterprises; an estimated 60 percent of agricultural production; 50 percent of scientific organizations; 100 percent of transportation.	Whole economy by 1 January 1989.
Planning	All enterprises and associations. However, in 1988, state orders make up 80 percent of industrial production, including 90 percent in the fuel ministries and 60 percent in the nine civilian machine-building ministries.	State orders will be reduced to 60 percent of total output in 1989, 50 percent in 1990, 30 to 40 percent in 1991, and "eventually" 20 to 25 percent.
Supply (wholesale trade)	Less than 4 percent of total industrial production; 15 to 20 percent of sales through state supply networks.	Wholesale trade reform to cover 30 percent of sales through state supply networks by 1989, 60 percent by 1990, and 80 percent (two-thirds of total sales) by 1992.
Banking	All banks. A reorganization is being undertaken, but decentralization of bank lending policies will be limited and gradual.	No date given.
Wholesale prices	None; to begin in 1990.	Industry, transportation, and communications by 1 January 1990; construction and agriculture by 1 January 1991.
Retail prices	None; to begin only after full public discussion.	Whole economy, presumably including retail, by 1991.
Foreign trade	In 1987, included ministries and enterprises that accounted for 26 percent of all imports; 14 percent of all exports. No official increase given for 1988.	No date given.
Organizational changes	All central ministries, republic central committees, and republic Council of Ministers.	By end of 1988.

[Redacted]

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January. An economist from the Institute of Economics admitted to US Embassy officers that such problems have forced Soviet economists to admit that the 13th Five-Year Plan period (1991-95) will be the time of transition to the new system—not the present plan period as originally anticipated. [Redacted]

staffs of Gosplan and the State Committee for Material and Technical Supply (Gossnab) and a sharp curtailment of their functions. Gorbachev's criticism of both organizations at the plenum indicated his extreme dissatisfaction with their traditional methods of operation. However, the reform decrees became compromise documents that failed to satisfy either radical reformers or traditionalists. The reforms called for Gosplan to shift away from day-to-day management of production and concentrate on "strategic" planning, but the nebulous wording of the Law

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The Planning Reforms

Progress. Deciding how to decentralize the planning system apparently was one of the most contentious issues during preparation for and at the June plenum. Gorbachev reportedly pushed for the more "radical reforms," including a 50-percent reduction in the

on State Enterprises and the reform decrees appeared to allow a large measure of interference from above, particularly in the form of state orders and normatives.³ [redacted]

According to testimony from Gorbachev and others down to the enterprise level, the loose language is indeed allowing the planning authorities and the ministries to resist change:

- In October a worker wrote to *Izvestiya* complaining that state orders for 1988 at his enterprise amounted to a 150-percent increase in output over the previous year.
- In November the Minister of the Machine Tool and Tool Building Industry complained on Soviet television that state orders made up 86 percent of production in that industry and even reached 100 percent for some enterprises.

- [redacted]
[redacted] Gosplan is defining state orders so that they consume virtually all of many enterprises' output—leaving nothing for discretionary use. He also complained in the Soviet press that ministries had decreed “confiscatory” normatives, leaving enterprises with 10 percent or less of their profit.

- In February Gorbachev criticized the “center” for continuing to issue commands through state orders, and a March Politburo meeting accused Gosplan of improper guidance in drawing up state orders that had limited the independence of enterprises.

³ Gosplan and the ministries are to draw up a mandatory bill of *state orders* for enterprises that will cover defense production, products needed to implement the Science and Technology Program, and other undefined goods needed to satisfy social tasks of state importance, ensure economic independence, and guarantee agricultural deliveries. These same organs are also to set *economic normatives*—ratios between related economic indicators such as production and wages—that regulate, among other things, growth of total wages, payments for capital and labor, and the allocation of profits among various kinds of taxes and funds. These normatives are to remain stable throughout the five-year plan period. [redacted]

- Nikolay Shmelev, one of the more radical reform economists, complained that ministries had fixed the normative for total profit an enterprise had to turn over to its parent ministry and the state at 92 to 94 percent.

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- In a recent interview in *Izvestiya*, a plant director described wrestling with the ministry over profit normatives for 1988 as a life-and-death struggle. After he finally succeeded in getting it to agree to stable profit normatives, he discovered the ministry had revised his depreciation deduction rates, which in effect took away the extra profit margin he thought he had won. [redacted]

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This interference by the central authorities, in addition to other problems, is making it difficult for the enterprises to implement *self-financing*—a pillar of the reforms and the avowed goal of all enterprises by the end of 1989. In theory, full “economic accountability and self-finance” means that all current and capital expenditures are financed from sales revenues and other internally generated funds. The enterprise has the authority, within limits, to distribute its profits among its three funds—the bonus fund, the social development fund, and the fund for financing research and development and investment. Enterprises on self-financing are discovering, however, that they are not profitable enough to finance the necessary expenditures, that the ministry is draining the profits of successful firms to keep the losers afloat, and that, even with money to spend, the necessary materials and equipment are not available. [redacted]

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Confronted with these problems in public forums, ministry and Gosplan officials have declared their right and responsibility to monitor enterprise progress in order to meet the plan and fulfill the modernization program. [redacted]

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[redacted] for example, “a ministry cannot be separated from oversight over the cause of fulfillment of one- and five-year plans.” During a discussion with Western Soviet specialists, Abel Aganbegyan implied that

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ministerial intervention was still necessary to ensure the fulfillment of the five-year plan, which was drawn up before the reforms were developed, and to substitute for the price and wholesale trade reforms, which were not yet in place. [redacted]

contest; the authorities were defining their new responsibilities as broadly as possible, and enterprises that wanted increased autonomy in most cases were unable to use the Law on State Enterprises as protection. [redacted]

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The Soviets have taken steps to deal with some of these problems:

The laws being drafted to limit state orders and clarify ministerial responsibilities are attempts to correct this imbalance, but it is unlikely they will do the trick. Efforts by the ministries to maintain control are not surprising because they continue to be held responsible for plan fulfillment in their subordinate plants and because the plans were drawn up before the reform legislation was completed. Moreover, key reforms meant to substitute economic levers for administrative directives, such as price reform, are not even close to implementation. [redacted]

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- Selected plants have been allowed to negotiate with the authorities over their plan targets. In the most publicized case, *Izvestiya* reported that the enterprise Uralmash refused to accept the 1988 plan handed down by the Ministry of Heavy and Transport Machine Building because it believed the plant's goals were unattainable and 93 percent of its production was covered in state orders.

- Financial relief has been provided for enterprises unable to cope with the rigors of self-financing. A recent two-part article in *Sotsialisticheskaya industriya* revealed that machine-building enterprises on self-financing were in deep financial trouble. As a result, the ministry has initiated a debt-forgiveness program and granted temporary preferential-term loans designed to ease the transition to self-financing. Also, Gosbank has been granting 10-day loans since January to enable enterprises to make their wage payments on time.⁴

Wholesale Trade

Progress. Wholesale trade reform⁵ is to be implemented over the next four to five years—making it, along with price reform, one of the last reforms to be completed. This delay reportedly is a result of an ideological controversy over the legitimacy of wholesale trade under socialism and a legitimate concern that a major reform in the supply system could cause widespread disruptions in the economy. The concern of a number of Soviets, however, is that the slow pace of wholesale trade implementation will have a negative impact on other reforms, particularly self-financing.

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- [redacted] Gosplan and Gosstab are working on a statute that will limit the size of state orders and delineate the rights of enterprises when they receive them. Also, a new regulation on ministries will define the limits of their power, according to Institute of Economics director Leonid Abalkin.

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Prospects. The reform provisions indicated that basic disagreements over centrally dictated plan indicators had not been resolved. As a result, lower level officials and factory managers were left to battle it out with the ministries. It was soon clear that it was an uneven

In March 1987 the first phase of reforming the supply system began at some 10,000 organizations, including:

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- One production ministry—the Ministry of Construction, Road, and Municipal Machine Building.

⁵ Wholesale trade is defined here as a system in which enterprises, without need of authorization, freely purchase items, including producer goods, from another enterprise, manufacturer's outlet, or territorial supply organization. [redacted]

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⁴ As part of the banking reform, the bank now automatically debits enterprise accounts as bills fall due—the so-called calendar system of payments. For enterprises existing close to the edge, this results in deficient funds on payday. [redacted]

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- Scientific-research institutes.
- Various construction organizations (including those in Armenia and Estonia).
- Several agroindustrial complexes.
- A number of ministries in the service sector, including the Ministry of Health and the Ministry of Culture.

This reform made Gosstab's territorial supply organizations the key contact points for enterprises in obtaining and disposing of supplies, which relieved the enterprises—at least in theory—of having to deal with central Gosplan and Gosstab in Moscow and their own ministries. In practice, however, enterprises were not able to deal directly with other enterprises in acquiring or disposing of supplies. [redacted]

This territorial approach appears to have been a middle ground between continued tight central control and true wholesale trade. The decree met with severe criticism by several Soviet economists who described it in the press as timid and an "old product in a new wrapper." Reacting to a suggestion that real wholesale trade be introduced, one Gosstab official replied, "No one will let us breed anarchy in the country." The Soviet press claimed some success in this first stage of wholesale trade reform, but other articles indicated that operating procedures did not change appreciably; enterprises continued to overstate requirements and hoard extra materials and equipment. Moreover, Gosplan and Gosstab appeared unwilling to change their mode of operation. [redacted]

The second phase of this reform began with the publication of the July 1987 decree devoted to "restructuring material and technical supply." Unlike the 1986 decree that channeled orders through territorial supply organs and only after the completion of elaborate paperwork, the new decree allows the "free" purchase and sale of goods under direct contracts between enterprises or with state wholesale organizations and manufacturers' direct outlets. Only "particularly scarce" goods will continue to be rationed, but the list also includes inputs that are required to fulfill mandatory state orders. The process is to start with "groups of goods of greatest importance for consumer goods production, agriculture, construction, machinery production, needs of cooperatives, and private producers." [redacted]

Prospects. The early signs are that Gosstab and many enterprise managers are finding it difficult to let go of the old system. Gosstab, an entrenched bureaucracy with a tradition of conservatism, has been placed in charge of this reform's implementation—the proverbial fox in the hen house. Gosstab officials are already narrowly interpreting the reform decree. [redacted]

[redacted] the major focus of the reform is not free exchange of goods among plants, but territorial reorganization of the supply system. [redacted]

Enterprise managers appear interested in the general concept of wholesale trade but are reluctant to give up guaranteed sales and supplies. There is evidence, on the one hand, that some enterprise managers have been scrambling to make their own arrangements to obtain supplies and sell their products. On the other hand, they are trying to obtain exemptions or are clamoring to obtain state orders—mandatory orders by Gosplan for which supplies and sales are guaranteed. This type of response seriously inhibits the growth of competition among enterprises that the reform is intended to foster. [redacted]

Reform economists point out that wholesale trade before price reform makes little sense because enterprise managers need rational prices to guide their supply decisions. As Abel Aganbegyan noted in the November issue of *The Economics and Organization of Industrial Production* (EKO), "the price of fuel oil . . . in many regions is lower than the price of coal. But, if we change over to wholesale trade in fuel oil, it turns out to be advantageous to burn it instead of coal . . . but from the standpoint of the state this is absolutely disadvantageous." He also notes that the changeover to wholesale trade is impossible as long as there is surplus money in circulation, which he blames on the loose use of credit. [redacted]

Banking Reform

Progress. Implementation of the July 1987 decree on banking reform began on 1 January. This decree:

- Reorganizes the banking system.

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- Decentralizes bank decisionmaking somewhat as a complement to increased autonomy at the enterprise level.
- Elevates the role of economic criteria in extending credit.
- Forces both banks and borrowing enterprises to assume greater financial responsibility.
- Attempts to improve the banking system's ability to balance money resources with goods.

Under the old system, the Soviet State Bank (Gosbank) was a monopoly bank that monitored money circulation; served as a center for the settlement of all the economy's accounts; provided short-term and some long-term credit financing to enterprises and set all interest rates, lending criteria, and loan limits; controlled allocation of foreign exchange; and set exchange rates. Other banks, such as Stroybank (the Construction Bank), performed specialized banking functions. The banking system granted credits as a matter of course—even to unprofitable enterprises—since it had little authority to apply strict economic criteria to banking operations. Soviet economists claimed that, as a result, there was a persistent imbalance between the money supply and available goods and little economic rationale or discipline in loan extension or repayment.

Under the new organizational structure, several new banks have been established and some existing banks have been restructured. *Gosbank* will begin to function more as a Western-style central bank: it will set lending policies, regulate the money supply, and coordinate the activities of the specialized banks. Local banks will take over many lower level lending decisions now made by Gosbank and planning organs. In the foreign field, Gosbank will continue to set the country's foreign currency policy, set official rates of exchange, and represent the USSR in relations with other central banks. The renamed *Bank for Foreign Economic Activity (Vneshekonombank)*, will continue to handle and finance foreign trade transactions. The former Stroybank, which handled banking services for most domestic economic sectors, has been abolished and replaced by three new, smaller banks—*Promstroybank*, *Agroprombank*, and *Zhilsotsbank*—in order to provide more specialized service. Finally, a new

savings bank, *The Workers' Savings and Consumer Credit Bank*, opened with expanded services to the populace.

Under the reform, Soviet banks will operate according to new procedures and success indicators. On 1 January the entire banking system switched to self-financing under terms and conditions similar to those being introduced in other sectors; all bank expenses must be covered by revenues, and profits will be used to build incentive funds for workers, for investment, and the like. Some banking decisions have been decentralized somewhat. Gosbank, jointly with the Ministry of Finance and the Council of Ministers, sets general guidelines for interest rates, but beginning 1 July 1988 specialized and local banks will have the autonomy to increase or decrease them by up to 50 percent. Similarly, although overall and sector loan limits are set by Gosbank, local banks, after negotiating with enterprises, can determine the breakdown among loan recipients.

Loan criteria are now stricter and include the projected use of credits, the financial health of the enterprise, and its repayment history. According to the banking decree, priority is to be given to those projects that promote scientific-technical progress and renew capital stock. In theory, local banks may declare insolvent any enterprise that systematically incurs losses or is erratic in payments to the budget, banks, and suppliers. Enterprises are to make all payments as they fall due and cannot delay repayment of bank credits, as they have in the past. The calendar system of payments has exacerbated enterprise liquidity problems, and the banks have stepped in, providing 10-day loans on preferential terms to cover wages. These bridge loans are available only up to 1 July 1988.

In recognition of the need to balance "money income and expenditure of the population," banks are enjoined to aid the formation of cooperatives and private businesses and state sector development that produces consumer goods and services. The Law on Cooperatives permits establishing cooperative banks to tap consumer savings in funding cooperative enterprises.

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In another effort to absorb money from the population, ruble savings certificates were made available beginning on 1 March 1988. [redacted]

Consumer banking services are also being expanded. Checking accounts were offered beginning on 1 December 1987 in the RSFSR and are being expanded this year to additional republics. Credit cards, for use by Soviets and foreigners with hard currency bank accounts in the USSR, will be issued through a joint venture between a Western VISA company and *Intourist*, the Soviet state travel organization. A credit card for Soviets with ruble accounts will be issued by a new Soviet firm called *Inturkart* and will be phased in slowly. [redacted]

Prospects. The bank reforms are intended to improve economic accountability—both in the banks and the enterprises—and ensure a more rational distribution of bank resources. The resulting credit discipline is supposed to force enterprises to consider profitability and thus be more responsive to their consumers' demands for quality and variety of goods and services. Success, however, depends on the implementation of the entire reform package, including price reform, which is not scheduled to be completed until the next decade. A rational price system is essential to determining real enterprise profitability—an important criteria for making loans or enforcing bankruptcies. A reformed system of wholesale trade that ensures the availability of supplies for output and investment objectives is also essential to ensure that loaned funds can be spent. [redacted]

Banking officials and some of the decree's provisions indicate that Gosbank will retain strong central controls, at least for the present. There is reason to doubt that the regime will be hardnosed in meting out bank resources based solely on profitability criteria, particularly in this reform transition period:

- The bank decree contains clauses that ensure that economic management organs will maintain ultimate control over the financial mechanism and that fulfillment of the state plan will continue to be the most important objective.

- In the event that a project is deemed "inefficient," the bank cannot deny funds unless it gets approval from the ministries and other economic authorities.

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- Even if enterprises cannot pay their suppliers and do not meet the criteria for bank credit, central ministries may allocate to them resources from centralized funds.

- The procedure for declaring an enterprise insolvent is long and arduous. [redacted]

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Price Reform

Progress. One of the last elements of reform to be implemented will be price reform—even though Soviet economists consider it to be the linchpin of economic restructuring. The July decree lays down general directions for price reform, but the details will be worked out and implemented in stages beginning in 1990. The major provisions of the decree are that:

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- Unlike its predecessors, this reform encompasses all forms of prices—wholesale, procurement, and retail prices—and specifies that changes in the various sets of prices are to be interrelated.

- Pricing is to be decentralized somewhat; there will be "three tiers" of prices—those set on a centralized basis, those established independently by the enterprises, and those reached by contractual agreement between enterprises.

- Pricing is to become an integral part of the formulation of five-year plans—a feature intended to ensure the "stability" of prices.

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- Prices are to be fixed on the basis of "socially necessary expenses of production and sale, utility, quality, and effective demand," but "unjustified profits" earned through "breaches of state price discipline" will be appropriated and the guilty enterprises fined. [redacted]

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According to the decree, *industrial wholesale prices* are no longer to be based primarily on costs but on "efficiency, quality, technical-economic characteristics, and consumer qualities." Prices for goods that have been heavily subsidized in the past, particularly fuels and raw materials, will be raised substantially. According to Nikolay Petrakov, deputy director of the Economics and Mathematics Institute, increases in these wholesale prices could be as high as 125 percent for gas and power-station coal, 200 to 300 percent for oil, and 40 to 50 percent for metal and electricity. Such hikes, according to Price Committee Chairman Pavlov, are necessary to "destroy the illusion" that such resources are cheap and inexhaustible and to create the necessary incentives for the design, production, and application of resource-saving equipment.

[redacted]

Prices are to be reduced for certain kinds of electronic equipment and high-tech machinery—a move designed to stimulate industrial modernization. As Petrakov pointed out in a recent article, surcharges on wholesale prices have raised the overall price of machinery to the point that renovation of productive capacity and assimilation of new equipment have been discouraged. "The main problem," he concluded, "is that equipment which has long been fully assimilated, or even outmoded, continues to be profitable to operate."

[redacted]

The preferential wholesale rates for industrial output sold to the agricultural sector—chemical fertilizers, cars, and farm machinery—will also be eliminated. Farmers will have to pay for the water they use for irrigation, and industrial and agricultural enterprises will now pay the same rate for electricity, heat, and natural gas. According to Pavlov, this will force the farmers to buy only the "most efficient" products and to limit their purchases to those they actually need.

[redacted]

These revised industrial rates will increase farm production costs and are to be compensated for by higher *procurement prices*—the prices paid for agricultural products sold to state procurement agencies. The new prices will add 30 billion rubles to the procurement bill—11.7 billion of which is intended to cover the

higher wholesale prices. The new procurement prices are also intended to cover the new charges for irrigation water, which the farmers now receive free.

[redacted]

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The pricing decree called for other changes:

- The number of procurement price zones will be reduced. This system paid higher prices for the products of farms operating at higher costs because of less favorable climate and soil, but Soviet economists complained that this policy allowed farms to recoup excessive costs and has not encouraged production to be concentrated in areas where it could be carried out at comparatively low costs.
- Financial aid now given to low-profit and money-losing farms in the form of special supplements to procurement prices will be abolished. Instead, successful farms will be charged land rent, which will go into a special fund to help poor farms.
- Procurement prices will vary more widely according to the quality of farm produce, and prices will be more widely differentiated by the season the produce is marketed.

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Although the price reform as a whole is supposed to be completed before the beginning of the next five-year plan in 1991, the pricing decree does not set a specific target date for the politically sensitive task of revising *retail prices*, as it does for wholesale and procurement prices. It is assumed that the retail price reform will reduce the subsidies for certain foods, rent, and consumer services. Sensitivity to this issue is apparent in the pricing decree, which promises that major changes in retail prices will not be made without a full public discussion and will not result in a lower standard of living.

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Despite agreement among most Soviet economists that retail prices must be raised to more fully reflect costs,

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[redacted] no decision had yet been made about the size of those increases or how many stages will be required to implement them.

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[redacted] a minority of Soviet economists seems to be challenging even the need for such retail price hikes, especially for food. A. Shamov, an economist with the Academy of the National Economy, recently wrote that it would be better to concentrate on reducing the costs of producing, storing, transporting, and processing food than to increase food prices. Political commentator Fedor Burlatskiy also has worried about the potential political impact of such price hikes, warning that the "enemies of reform" might exploit the problems resulting from increased food prices. [redacted]

For the most part, however, Soviet economists have been focusing on the issue of how best to compensate consumers for the expected price increases. [redacted]

[redacted] three options have been considered: a reduction of prices for consumer durables and soft goods, abolition or reduction of income taxes on wages, and supplements to wages and pensions. Recent evidence—including statements by General Secretary Gorbachev and Price Committee Chairman Pavlov—indicates that most of the attention is now focused on wage supplements but that several issues have yet to be resolved. [redacted]

Prospects. The intended revision of industrial and procurement prices will bring them more in line with costs, and the removal of price subsidies is a step toward more efficient use of inputs. But the emphasis on price *revision* rather than on reform of the pricing mechanism itself means that prices will remain poor guides to economic decision making. The procurement price revisions, for example, do not change the essential nature of the cost-based, administered system of procurement prices. [redacted]

Reform-minded Soviet economists, who initially seemed pleased with any movement at all on the price reform issue, are now calling attention to the reform's deficiencies and pushing for bolder measures. For example, [redacted] it was not enough simply to delegate price-setting authority to lower levels. What was needed [redacted] was the

"creation of conditions whereby price is influenced by the consumer of a given product himself through the market." [redacted] also has called for a pricing system based on supply and demand, concluding that, in the absence of such a system, "we have absolutely no guarantee that the present situation will not recur." [redacted]

[redacted] reform economists are now agreed on the need for an entirely new price-setting system but that they remain at odds over the design of that system, as well as other matters, such as compensation and monetary reform.

[redacted] "massive disagreement at the political level" was responsible for the vagueness of the July decree. [redacted] the current debate will be useful in informing policymakers about the complications and potential consequences of various options. [redacted]

Foreign Trade Reforms

Progress. Reforms in the foreign trade sector antedate the June plenum reforms. Beginning in January 1987 more than 20 ministries and 70 large associations and enterprises were granted the authority to conduct trade directly with all foreign partners, rather than through the Ministry of Foreign Trade (MFT). This realignment of authority was an attempt to place more responsibilities for trade at the production level, where end users of the imports can deal directly with the exporter, removing the MFT as a cumbersome middleman. The June 1987 reform provisions did not include additional foreign trade reforms, but merely called for enhancing the use of financial-credit levers in promoting the expansion and efficient conduct of foreign trade. They also called for implementing a "stage-by-stage" convertibility of the ruble, starting with the CEMA trading system. [redacted]

At the same time, Moscow sanctioned the establishment of joint ventures with Western firms. Moscow sees this type of business deal as a better and less expensive way to acquire and assimilate Western technology, managerial expertise, and marketing

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skills than current trade and economic practices. Since the late 1970s, the Soviet leadership has expressed disappointment over the failure of imports of Western machinery and equipment to make the expected contribution to industrial output. [redacted]

The most recent reform effort—and probably the most confusing to both foreign and domestic observers—is Moscow’s replacement early this year of the MFT and the State Committee for Foreign Economic Relations, the body that administered economic aid, with a single Ministry of Foreign Economic Relations. [redacted] the Soviets have not yet determined the exact structure and function of the new ministry, but the reshuffling is likely to affect the reforms already in place. For example, Moscow probably plans to give additional ministries and enterprises independent foreign trading rights. In addition, the Chamber of Commerce and Industry will have an expanded role in foreign trade. [redacted]

Confusion stemming from the foreign trade reorganizations has disrupted trade during the past year and a half. [redacted] both Western businessmen and Soviets are struggling to cope with the new problems that were created:

- The lack of trade experts at the ministry and enterprise level has been a major shortcoming. Western businessmen, for example, blame the inexperienced personnel at Soyuzkhimeksport (the organization responsible for chemical exports) for being unable to fulfill contract obligations and to meet many sales conditions.
- Negotiations have been delayed because confusion exists as to which personnel are responsible for trading specific commodities. [redacted]

The establishment of joint ventures on Soviet soil also has not materialized as the Soviets had initially expected, despite a widespread campaign. Indeed, the leadership’s emphasis on joint ventures may actually have inhibited trade because many Soviets are over-looking other economic arrangements with the West

that could have a more immediate impact on industrial modernization. Although Moscow has received more than 300 project proposals, only 37 agreements have been concluded. Western firms have shied away from signing deals largely because of their concern about profitability and the vagueness of existing joint-venture legislation on important issues such as management control, profit repatriation, raw material supply, product pricing, and the valuation of capital contributions. Finally, Western firms are willing to tap a large and potentially lucrative Soviet domestic market, but they remain reluctant to help the USSR become another exporter of manufactured goods competing on the world market. The Soviets are largely dissatisfied with the progress of joint ventures, and an official recently indicated that Moscow is studying plans to change the joint-venture regulations. [redacted]

Prospects. Tinkering with the foreign trade sector will continue to impede trade relations in the short run but could produce benefits over time. Closer contacts between producers and Western firms could eventually speed up negotiations and allow Soviet managers to order equipment that more closely meets their specifications. Without further changes in the system, however, the independence of the enterprises will continue to be limited because Moscow can influence trade through regulation of import and export prices, foreign currency exchange rates, customs tariffs, and interest rates on credit. [redacted]

Likewise, joint ventures will probably have little impact on Soviet hard currency earnings or the quality of domestic production during the remainder of the current five-year plan period. Only a limited number of significant joint ventures are likely to be in operation within the next year or two. Most of the deals concluded to date or those close to signing appear to be relatively small endeavors that involve simple production processes, low-level technology, and little foreign capital. Over the longer term, Moscow stands to reap benefits from even a small number of joint ventures. These projects could help improve the performance of certain industries, increase skills of selected personnel, and provide access to new foreign

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markets. How far and how fast Western skills and work habits spread to other Soviet industries, however, will hinge largely on the progress of Gorbachev's domestic economic reform package, not on the number of joint ventures with the West. [redacted]

Organizational Reform

Progress. Gorbachev has long viewed major change in the role of the ministerial bureaucracy as vital to his effort to move away from the Soviet command-style economy toward a more "self-regulating" system. He has repeatedly stressed that the ministries and other central planning organs must now focus on "strategic" tasks and refrain from day-to-day regulation of production. He holds that the unwieldy structures and huge staffs of the bureaucracy are no longer necessary and must be sharply reduced if the ministries are to be blocked from administrative tutelage of enterprises. [redacted]

Gorbachev began the process of streamlining the government bureaucracy late in 1985 with the merger of five agriculture-related ministries and one state committee to form the State Agroindustrial Committee (Gosagroprom). Subsequently, five interministerial coordinating bureaus were created to supervise the work of groups of related ministries. These reorganizations were accompanied by steps to eliminate some intermediate links of administration and by reductions in staffs (a 49-percent reduction was officially claimed for Gosagroprom). It proved difficult to streamline the ministerial bureaucracy, however, in the absence of any fundamental change in the centralized system of economic management. The process of creating overarching bureaus and commissions was not completed as reportedly planned, and the reorganization drive apparently ran out of steam by the fall of 1986. [redacted]

Gorbachev sought to rectify this at the June 1987 plenum by announcing that a streamlining of the bureaucracy would be part of his comprehensive set of measures to decentralize economic decision making. This time the emphasis is mainly on staff reductions and the reorganization of ministerial departments—and less on the elimination of ministries. [redacted]

General guidelines for the *staff cuts* appear to have been circulated to the ministries, but they have not been published and only the broad details have come to light. [redacted] the staffs of the branch ministries are to be reduced by 50 percent by 1990 and Gosplan and other functional departments are to be cut by 30 percent. The state bureaucracy is to be reduced 50 percent at the republic level and 30 percent at the oblast level. Only at the district and city levels, where decisionmaking authority is slated to increase, is some growth for the management bureaucracy projected. Altogether, according to TASS, 3 million managerial jobs are to be eliminated by 1990. [redacted]

These reductions will not put as many people out of work as the numbers suggest. A portion of the cuts will be accomplished by scheduled retirements or "early outs"; possibly one-third of those let go will be found jobs within the same administration; and an effort is being made to encourage released personnel to take jobs directly in production and to go to areas where new industries are opening up. A January 1988 decree stipulates that those being laid off will be guaranteed severance pay for three months, will be allowed to keep their Moscow address even if they accept a post in the provinces, and will be entitled to their present salary for at least one year if they have to accept a lower paying job. [redacted]

In the area of *departmental reorganization*, the goal is to shift to a two-tiered administrative structure in order to increase the operational authority of the enterprises and to eliminate all intermediate links between the ministry's leadership and its subordinate production associations and enterprises. New organizations called state production associations (GPOs) are being established, but Soviet spokesmen insist that these do not constitute a new bureaucratic layer. [redacted]

Efforts to reduce significantly the number of *ministries* appear to have stalled, although the broad strategy—to sharply reduce the number of ministries [redacted]

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after the establishment of coordinating bureaus for all the major sectors of the economy—has long been agreed upon. No specifics were mentioned at the June plenum, [redacted]

[redacted] A decree on the “reorganization of the Council of Ministers” is still expected. Opponents of further ministerial mergers have probably been aided by the many problems encountered by earlier efforts, such as the formation of Gosagroprom. Although designed to serve as a model for the reorganization of the rest of the economic bureaucracy, Gosagroprom has been a major disappointment. [redacted]

Nevertheless, some progress, but of a relatively minor nature, has been made in reducing the number of central ministries:

- Four machine-building ministries were merged into two, and one other was abolished.
- Seven union-republic ministries in the field of energy and natural resources were reorganized into all-union ministries and their republic-level ministries abolished.
- The Ministry of Foreign Trade merged with the State Committee for Foreign Economic Relations.
- Most recently three education administrations were merged into a state committee. More restructuring is under way at the republic level. [redacted]

The pace of reorganization has picked up noticeably in recent months. Although the ministries and other central departments apparently were instructed to submit plans for reorganization and reduction by the end of December 1987, most did not meet this deadline, and a new push was on to complete this phase of reorganization by mid-April. The removal of Gosplan Chairman Nikolay Talyzin in early February also should reduce that organization’s resistance to restructuring. Gosplan’s foot-dragging was almost certainly a factor in the halfhearted compliance with the streamlining directive throughout the government, and it reportedly weighed heavily in Talyzin’s ouster. [redacted]

Prospects. The ability of the government bureaucracy to resist all efforts to make it focus on strategic questions, rather than on day-to-day regulation of

production, poses a major threat to Gorbachev’s reform program and will have to be overcome if the program is to succeed. But the belief that simply reducing the size of the bureaucracy would curb its power may turn out to be misguided and—at least in the short run—counterproductive. So far, that effort is creating ill-timed disruptions and widespread resentment that is likely to fuel opposition to the reform program and to Gorbachev personally. [redacted]

[redacted] Gorbachev is now trying to distance himself from economic issues but is certain to be perceived as the principal instigator behind the current reductions in force. According to the editor of the journal *Ogonek*, party secretary Yegor Ligachev has opposed deep cuts in the bureaucracy, which he regards as part of his power base, and he is likely to benefit politically from the resentment being generated. [redacted]

Among reformers there is growing cynicism that this effort is just another reshuffling that will reduce neither the size nor the role of the bureaucracy. Particular concern is focused on the new GPOs. Reformers claim that GPOs are turning into dumping grounds for released officials and are no different from the main administrations (a bureaucratic layer between the ministry and enterprise) they were intended to replace. “They reek of the old bureaucracy,” wrote one reformer. Moreover, reformers argue that major streamlining will not by itself end ministerial micromanaging as long as ministries continue to be burdened with the responsibility for the economic performance of their sectors. Because selections of new people are occurring while the bureaucracy is still operating under the old system, they also worry that those who remain are “people who thrive on bureaucratic procedures.” [redacted]

Despite these misgivings among conservatives and reformers alike, Gorbachev appears determined to continue planned reductions. The Politburo meeting on 3 March issued an upbeat assessment of the restructuring process and expressed satisfaction with the progress to date. Gorbachev may be counting on

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the dismissal of Gosplan head Talyzin to clear the way for other measures to reduce the powers of the government bureaucracy. [redacted]

Private-Sector Reforms

Progress. Leadership support for expanding the legal private sector appears to be growing and has resulted in significant new legislation to encourage cooperatives and individually run businesses. Although not a part of the reform package that came out of the June plenum, reforms in this sector complement those in the state sector—transferring more economic decision making to the local level and making the economy more flexible and responsive. [redacted]

During late 1986 and early 1987, the Gorbachev regime gradually introduced legislation promoting member-run cooperatives and individually run businesses (“individual labor activity” in Soviet parlance) as a means of improving the quality and availability of consumer goods and services without major adjustments in the allocation of scarce resources. [redacted] [redacted] thus far the measures have affected only a small segment of the economy. [redacted]

The slow start is explained partly by limitations on eligibility for legal private activity. Legislation on self-employment and cooperatives has limited participation largely to housewives, students, pensioners, and state employees working during their free time. In addition, the range of cooperative activity has been limited to four types of business: consumer services, public catering, production of consumer goods, and recycling of raw materials. [redacted]

The main obstacles to legal private activity lie elsewhere, however. The regime has given local governments broad powers to implement the new legislation, but evidence indicates that many are blocking change. Local authorities are primarily concerned with accommodating the interests of state-owned and state-operated enterprises whose performance is key for the development of their regions and their personal success. Moreover, they have had little financial interest in supporting legal private activity. Self-employed individuals have paid their personal income tax or license fee to the USSR state budget. Cooperatives have paid their taxes to local authorities, but the tax

rates are very low. Like the self-employed, cooperative members have paid their personal income tax to the USSR state budget. Perhaps more important, local authorities appear to resent that the wages earned by private businessmen are often much higher than those of state employees. [redacted]

The regime’s efforts have also been hampered by the reluctance of citizens to register. People fear that the new initiatives will be short lived and that those who opt for legal activity now will suffer consequences later. Many people, especially illegal operators, do not believe the new, less burdensome tax rates for self-employment are low enough. Many citizens, like local authorities, are antagonistic toward the idea of others earning relatively high incomes. [redacted]

A new law on cooperatives—approved by the Supreme Soviet in May 1988—is the boldest step taken by the leadership thus far to promote the development of cooperatives. The law bolsters their ideological and legal underpinning, loosens the eligibility requirements for joining cooperatives, and broadens the scope of their activities. It also directs all revenues from new progressive tax rates for the personal income of cooperative members to local authorities, increases their access to credit, and allows “major” cooperatives to conduct foreign trade activities independently. The new law contains a separate section on agricultural cooperatives, which ostensibly frees collective farms from compulsory procurement targets. The state is to rely on attractive prices, the tying of guaranteed supplies to state orders, and other economic “levers” to ensure that agricultural production targets are met. [redacted]

Prospects. The draft law on cooperatives, as well as other measures taken by the leadership, represents a serious attempt to address problems of implementation. The law could begin to have a measureable positive impact on cooperative development during the second half of 1988. But the new law can only partially solve the thorny problems that impede substantial improvements in the quality and convenience provided to the consumer. The leadership will have to do more, for example, to overcome public and official

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hostility to private business. It must also convince the population and local authorities that policies on private business will not be reversed. Building credibility, however, takes time and more measures, like the law on cooperatives, that underscore long-term commitment. In addition, the leadership will have to continue to work to provide adequate incentives for local authorities, enterprises, and individuals to support private business. [redacted]

The Root of the Problem

The difficulties highlighted above can be traced to a common set of problems. First, enterprise managers have not been clearly apprised of their new tasks and responsibilities. Detailed instructions have not been issued nor chains of command in new organizations clearly delineated. Second, there is a basic conflict between the economy's traditional operating principles and the demands of the "new economic mechanism." That is, enterprise managers are reluctant to take risks and focus on quality and innovation as emphasized in the reforms because they are still obliged to meet high quantitative targets. Reform economists and even some in the leadership have begun to speak publicly about the need to play down the emphasis on quantity, but they have acknowledged in private that it is too late to change the ambitious plan goals for 1986-90. [redacted]

More serious are the loopholes in the reform legislation that allow the bureaucracy to resist change. The major unresolved issue is the proper role of the central authorities in guiding enterprise activity. At present, the ministry is held ultimately accountable for the production of its branch subordinates, being charged with "monitoring" their activities. This sets the stage for continued meddling in enterprise affairs. Also, implementation is difficult because only a portion of the economy has transferred to the new system, and crucial elements of the reform package are not scheduled for full implementation until the beginning of the next five-year plan period. Price reform—essential for rational economic decisionmaking—will not be completed until at least 1991, and the wholesale trade reform is not scheduled to reach its final objective until 1992. Finally, the reforms must be meshed with a five-year plan that was drawn up long before the reforms were promulgated. Ministries are still being

held to these goals and are issuing detailed commands to ensure their fulfillment despite the reform objective of enhancing enterprise autonomy. [redacted]

Implications and Outlook

The shaky start to the reforms will contribute to the uncertainties felt by plant managers, who must also contend with the pressures of modernizing the capital stock and expanding the previously disruptive quality control program. All of these initiatives will have at least a short-run negative impact on Soviet economic performance. Economic disruptions from the reforms alone could result from:

- Mixed signals over which success indicators to follow.
- Conflicts between ambitious output targets and new planning guidelines that emphasize quality output and the introduction of new technology.
- Confusion on the part of Gosplan, ministry officials, and enterprises over their changing roles.
- Delays in deliveries as plants whose production is not covered by state orders scramble to find suppliers or customers.
- Increased hoarding as enterprises try to protect themselves from supply interruptions and confusion over producer-consumer relations. [redacted]

The reforms may also increase labor-management tensions as plants struggle to adjust to the new procedures. Since January 1987, when self-financing began on a large scale in Soviet enterprises, 15 strikes were reported, most of which were related to the implementation of economic reforms. In general, workers became disgruntled because the reforms tie wages and bonuses more directly to performance, and yet worker productivity depends on factors beyond their control. So far, from the workers' viewpoint, the reforms have meant more discipline, less job security, slower wage increases, and only the promise of an eventual payoff in terms of more consumer goods and services. [redacted]

The leadership must take effective and immediate action to get the reforms back on track or risk delaying the payoff period until well into the 1990s. It was Gorbachev's original intention that the reforms

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be "almost fully in place" by the beginning of the next five-year plan period (1991-95). Many Soviet economists now believe that the transition period will be later and that major improvements in Soviet economic performance cannot be expected until the early-to-middle 1990s. [redacted]

[redacted], this might be dangerous because, if the Soviet consumer does not see tangible results within the next few years, "the future of restructuring could be in jeopardy." [redacted]

Policy initiatives that would indicate the leadership recognizes the root of the reform implementation problems and is ready to take effective action would include:

- A relaxation of taut output targets.
- A speedup in the implementation schedule for wholesale trade reform.
- More flexibility allowed immediately in wholesale price formation.

- More latitude granted to the enterprise in planning its output and in distributing and spending its funds for investment and incentives.
- A substantial reduction in the ministerial apparatus.

[redacted]

Work is under way in at least two of these areas (wholesale trade and state orders, as discussed above) but it is unclear how far the new directives will go. The upcoming party conference is scheduled to discuss the progress of the reforms. New initiatives in these problem areas announced at that time would send a clear signal that the leadership is committed to hewing to the original intent of the reformers and that it realizes the serious consequences of letting the situation drift. [redacted]

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