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Economic Reform in the USSR

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ECONOMIC REFORM IN THE USSR**CONTENTS PAGE**

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The subject of economic reform is probably as large as the problems with which it has to deal. In order to understand why such a reform became necessary after 70 years of socialist development, it is essential to see it in historical perspective.

I. The need for reform

Since 1950 the national income of the USSR in real terms has increased ten-fold and income per head of the population five times. The economic and technological capability of the country has been enlarged tremendously. Judged by per capita consumption of goods and services the USSR still lags behind the USA and other major industrial capitalist countries, but a new way of life has emerged there which is characterized by a cycle-free development of the economy, guaranteed right to work, no unemployment, steady improvement in the standard of living and confidence in the future. Yet, despite the considerable achievements of the Soviet economy since World War II, particularly in reducing the gap between the USSR and the West (Soviet GNP was 67 per cent of that of the USA in 1985, compared with 31 per cent in 1950), its economic performance has deteriorated in the last two decades.

TABLE 1
Main indicators of economic development
(Rates of growth, per cent)

Indicators	8th 5-year plan (1966-70)	9th 5-year plan (1971-75)	10th 5-year plan (1976-80)	11th 5-year plan (1981-85)
National income	41	28	21	16.5
Industrial production	50	43	24	20
Agricultural production ¹	21	13	9	6
Productivity of labour ²	37	25	17	16.3
Real income per capita	33	24	18	11.5

1 Five-year average

2 Throughout the economy

Source: Calculated from: Narodnoye Khozyaistvo SSSR v 1970 g. (Statistical Yearbook), Statistika, Moscow, 1971, p.37; Narodnoye Khozyaistvo SSSR v 1983 g., M., 1983, pp. 36-38; Narodnoye Khozyaistvo SSSR v 1985 g., M., 1986, p.38.

As shown in Table 1, the rate of growth of the main economic indicators has steadily declined, with national income growing only 16.5 per cent in the last five-year plan period which is less than one half of the growth in 1966-70. Similarly, industrial production grew by only 20 per cent in 1981-85 compared with 50 per cent in 1966-70, agricultural output by 6 per cent compared with 21 per cent, and real income per capita, by barely 12 per cent in 1981-85 compared with one-third in 1966-70. Towards the end of 1970s the rate of economic growth fell close to a stagnation level. The country began to lose one economic position after another. The technological gap separating it from the advanced Western nations started to grow again. This had not happened since the late 1920s.

This slow-down was, no doubt, caused partly by the deterioration in the over-all conditions of development. But to a larger extent it was due to the failure of economic policy-makers to take these changes into account.

Since the early 1970s a salient feature of the economic environment has been the decline in growth rates of the production inputs, i.e. the main resources needed for economic development - labour, investment, fuel and

TABLE 2

Decline in growth rates of production inputs
and efficiency of economic performance
(Five-year increments, per cent)

	9th 5-year plan (1971-75)	10th 5-year plan (1976-80)	11th 5-year plan (1981-85)
<u>Production inputs:</u>			
Fixed assets ¹	52	43	29
Capital investment	43	23	14
Production of raw materials and fuels	25	10	6
Labour force ²	6	4	2
<u>Economic performance³:</u>			
Fixed assets - output ratio	-16	-15	12
Returns on capital investment	-11	-2	0
Efficiency of raw materials utilization	2	10	8
Productivity of labour	21	14	12

1 "Capital stock" in Western economics terminology

2 Excluding services

3 Calculated on the basis of national income
utilization

Source: Calculated from Narodnoye Khozyaistvo SSSR
(Statistical Yearbook) for corresponding years.

materials. As can be seen from Table 2, fixed assets (capital stock) grew by less than 30 per cent in the last five-year plan period compared with 52 per cent in 1971-75, and production of fuel and raw materials grew only 6 per cent in 1981-85, compared with 25 per cent in 1971-75. The labour force showed very little growth in the first half of the 1980s.

Attempts were made to offset this downward trend by old means, i.e. by using more inputs yielding ever diminishing returns. But these led to a disproportionate build-up of the fuel and energy sector, an obsessive development of new natural resources and their irrational use, an unwarranted induction of additional labour reserves, growing financial tensions and declines in labour productivity growth, the capital-output ratio and other indicators of efficiency. Endeavours to remedy this situation by launching new construction projects aggravated the growing economic imbalance. An economy with immense resources available found itself faced with an acute shortage. A widening gap appeared between the needs of society and the level of production, between demand and supply. It clear that the system of the 'command economy' had reached the limits of its effectiveness. Its preservation could lead only to economic stagnation and social apathy.

To improve the situation, changes had to be introduced in the basic system of economic planning and management, the organization and methods of production, and in relations between social and economic factors in development. The inability to perceive in time the need for such fundamental changes and to assess the danger of the growing crisis together with the conservative mood and general inertia were among the main factors responsible for the slow-down. But there was also a lack of determination and persistence in

introducing long overdue structural changes in the economy, in the system of management and in the very psychology of conducting business.

There were more than enough good statements of intent and even good decisions. But they were implemented only partially or not at all. The measures taken to translate decisions into actions were wholly inadequate.

The inertia and inflexibility of policy were particularly flagrant in the field of technological innovation. The insistence of economic planners and managers of industrial enterprises on plan-fulfillment, i.e. reaching the planned quantitative targets (which had become the supreme criteria of economic performance), was the major reason for the neglect of qualitative aspects of production and for the relatively slow and unsatisfactory pace of technological change.

The economic mechanism that emerged in the 1930s and 1940s, which was primarily geared to increasing the production of the same pattern of output (or one that changed slowly), was not designed for rapid structural change. But rapid change was the main feature of the scientific and technological revolution which began in the middle of the twentieth century. The system also lacked the necessary incentives required to encourage the development of new products and methods of production. By way of illustration, at the beginning of 1986 there were more than 300 major innovations ready for commercial use which were not utilized by Soviet industry.

This tremendous waste of resources and economic opportunities probably would not have happened if the country were not so enormously rich in natural resources,

export of which enabled the USSR to cover current needs and new technology imports - imports which should not have been necessary given the country's large domestic technological capacity. This reliance on exports of oil and other commodities concealed, for a time, the need for the adaptation of the economic mechanism to the changed conditions. But such a need was a clear historical necessity.

II New Strategy

In April 1985, when the new leadership came to power, a new approach to the economic and social development of the country was formulated. In February-March 1986, its concept was elaborated and approved by the XXVII congress of the Plenary Session of the Central Committee of the Communist Party (CPSU) the highest decision-making body in the country. The set of policies which has been in operation since then was further refined and made more specific in January and in June 1987, at a Plenary devoted entirely to the programme of radical economic reforms.

The essence of the new strategy is the concept of accelerating economic and social development by raising the annual rate of GNP growth from 3 per cent to 4 per cent in the next few years and to 5 per cent in the next decade. But the acceleration policy is by no means limited to higher rates of growth. It emphasizes the quality of growth, rapid advance in strategically important sectors of the economy, radical structural change and much greater attention to social aspects of development - food supply, housing conditions, health care, education and pensions.

In the past, the priority given to the development of industry and infrastructure meant that social expenditure

was essentially a "residual" - what was left over after productive investment spending had taken its share. Quite often new factories were given priority over housing, kindergartens, schools, services and recreation facilities. This has now been reversed and social targets have been given parity and in some cases even priority over economic ones.

What is even more significant is that the new policies encompass the democratization of political life, fuller participation of the people in the decision-making process at all levels, an irreversible move towards a more open society with "glasnost" (openness) becoming an essential ingredient of the Soviet way of life along with freedom of cultural expression. The current drive for restructuring thus amounts to a drastic shake-up of the entire Soviet economic and social order. In the words of M.S. Gorbachev, "in essence, we are talking about a turning point and measures of a revolutionary character... Such a turning point is necessary, because we have no other choice. We must not retreat and do not have anywhere to retreat to".¹

Given the overriding aim of improving efficiency - more output per unit of output - at all levels of the Soviet economy, the implications for the nation's traditional approach to economic policy-making are profound. The following are the main elements of the new strategy:

¹ 'Materially Plenuma Tsentralnogo Komiteta KPSS' (Materials of the Plenary Session of the Central Committee of the CPSU), 27-28 January 1987, Politisdat, Moscow, 1987, p.14.

1. New structural policy²

The new emphasis on science-based and other high technology industries will be at the expense of the old "heavy industries", mining and agriculture. Priority attention will be given to capital-saving technology. As in the late 1920s and 1930s when the first technological transformation took place, the key sector is seen as engineering and machine tools. But to perform such a task engineering itself requires a complete renovation. Hence:

2. New policies toward investment

This includes a radical redistribution of investment in favour of renovating old plant and equipment rather than building new enterprises, reducing and ultimately eliminating the dispersal of investments which led to lengthening the time of construction and freezing resources; and above all improving the efficiency of investment by placing more emphasis on the quality of production rather than on the increase of output. It also includes setting higher depreciation rates to avoid a situation in which a significant part of equipment in all industries is out of date. For this reason half of all the operating equipment in engineering will have to be scrapped before 1990 or thereabout. In short, the whole structure of investment must be changed in order to move from the extensive way of development to an intensive one.

3. Changing the economic mechanism

This is the key element of the whole strategy. Until recently, it was not customary to admit that anything was

² Called 'industrial policy' in western economics.

wrong with the planning or management system. Whenever there was a need to change it was usually expressed as a need "for the further perfection" of the system. By contrast, the new leadership makes no bones about the need for drastic change and radical reform. To reach this goal it was decided not to "deregulate" the economy by piecemeal changes in existing administrative structures (which would, of course, be easier given the habit of administrative solutions), but rather to pass legislation through the Supreme Soviet introducing the reforms which would constitute an integrated whole, encompassing general principles, specific measures and deadlines for implementation. It would also provide for an orderly transition from the old system of planning and management to a new one.

These reforms amount in essence to a reassessment of the role of the State in economic development, notably the role of central planning and decision making at the enterprise level and central versus local decision-making more generally. From now on central planning will concentrate on issues of national importance - the overall dimensions of the development effort, structural changes and the sectoral distribution of investment and eliminating bottlenecks, etc. It will lay-down the main development targets, but not interfere in day-to-day operational decision. These decisions will be left to individual enterprises, collective farms, co-operatives, research institutes etc.

The new legislation ("The Law on the Socialist Enterprise")³ which was passed by the Supreme Soviet in June 1987 is a corner-stone of the new economic mechanism. It defines the rights and responsibilities of the enterprise.

³ See: Izvestya, July 1, 1987.

It sets, notably, new rules for the use of profits (leaving much more discretion to enterprises to use them for technical modernization), and for decisions on employment and the level of wages. Among other things, it enhances democracy in the working place and provides for the election of managers by workers and employees. The emphasis is on the fulfilment of contracts rather than on the achievement of quantitative production targets. A newly established Government quality control service handles the problem of quality improvement - the primary condition for raising the competitiveness of Soviet industrial products on world markets. A major innovation intended to increase the freedom of decision-making by the enterprises is the introduction of wholesale trade in machinery, equipment and other means of production in place of the present supply system based on rationing and administrative distribution of these items. It is hoped that this measure will eliminate perennial shortages of investment goods on Soviet domestic markets and de-freeze over 300 billion roubles worth of inventories which now lie idle in warehouses throughout the country. The increased autonomy of enterprises is also seen as a means to reduce the power of the bureaucracy and enhance entrepreneurial initiative. This is the reason why the 1987 Law on the enterprise is of such momentous importance.

At the heart of the new reforms is the new incentive system: for management - incentives to innovate; for workers and employees - incentives to improve productivity. These will be offered by way of individual bonuses and the direct link between wages and performance. At the enterprise level, successful enterprises will be allowed to build up larger funds for social development, which may be used to finance the construction of creches, kindergartens, sports and recreation facilities. In this direction the Soviet Union has embarked on a voyage of discovery - exploration of the

boundaries of income differentials that are compatible with socialism.

4. Changing the system of price formation

The importance of this stems from the fact that prices in the Soviet Union very often do not reflect the real value of goods, however defined (in terms either of cost or consumption value). Sometimes they bear no relation at all to the real cost of the goods or services. For instance, the price of a ticket for the underground city transport in Moscow, which was set in 1935 at 5 kopeks, remains at 5 kopeks more than half a century later. The rent for a three-room flat in a modern apartment house is typically 15-20 roubles per month; the price of a kilo of wheat bread is 25-40 kopeks, while the price of a four-seat ordinary passenger car (Lada 21013) is 7,500 roubles, and a colour television set, 700 roubles. Food prices are on average about one half of the real cost.⁴ Of course, these prices have no meaning if unrelated to prevailing wage and salary levels. But the point here is that their structure, which emerged as a result of a multitude of piecemeal government decisions in the course of nearly seven decades, is not consistent either with the real costs or with preferences of consumers.

Unless a thorough overhaul of the full price structure is accomplished, vital information about the functioning of the economy will never become available - including notably information about which enterprises work at a loss and which at a profit. Also it is recognized that prices of goods and services must reflect both their cost of production and their consumer valuation.

⁴ Pravda, June 13, 1987.

In no sphere of the economy is the wasteful effect of the present artificial price structure more evident than in agriculture, where the huge subsidies and loans (which later on are usually "forgiven") prevent the improvement of efficiency and, in effect, iron out the difference between well-managed farms and poorly run ones. So far no enterprise in the USSR has become bankrupt - the State has always bailed them out. This too, is acknowledged to be conducive to waste and inefficiency. To eliminate these phenomena a complete overhaul of the price structure and price formation mechanism is needed a truly formidable task.

5. Restructuring the credit system

The credit system is to be completely overhauled. Up to now loans to enterprises and individuals have been distributed at symbolic interest rates and appear as (nominally) repayable grants and subsidies, rather than credits as understood elsewhere. Many such credits, notably to state farms and co-operatives in agriculture, have never been repaid and have had to be forgiven. Now enterprises will be encouraged to use repayable credits for which they will be charged interest at rates expressing the real value of money at a given time. This is intended to enhance the entrepreneurial spirit of managers and at the same time introduce stricter financial discipline in the economy.

6. Re-assessment of the role of the services sector

Until recently a sizeable sector of economic activities has existed outside any state control. This so-called 'shadow' economy is believed to generate at least 15 billion roubles of annual income unaccounted for in the national accounts statistics. This has long been considered as "non-productive" and therefore a burden for the economy. Indeed,

the whole services sector has been unsatisfactory both in terms of the quantity and quality of services. Many service personnel have become extremely wealthy, illegally, paying no taxes, and risking heavy fines and prison sentences if caught

Now the need for a plurality of sources for the provision of services - public, co-operative and individual - is recognized. Up to now, these have been provided mainly by the government - public laundries, hairdresser salons, cleaning offices, TV repair shops etc. Now it is intended that some will be provided by the State, but others by co-operatives and individuals. .

The new legislation ("The Law on Individual Labour Activity") passed by the Supreme Soviet of the USSR in November, 1986 which came into force on 1 May, 1987, defines the areas, conditions, rights and obligations of individuals willing to engage in such activities, as well as their relations with the State (taxation, marketing, provision of materials etc.). This law has important economic, political and social implications. Firstly, it legalizes activities which in the past have been considered "underground". Secondly, it explicitly recognizes that such activities fulfil a useful function for the public and have nothing anti-socialist or anti-marxist about them. It will add flexibility to the economic system without affecting its social nature whatsoever. The new law is clearly one of the most important innovations in Soviet economic practice since the late 1920s, when NEP (New Economic Policy introduced by Lenin) was terminated.

7. Restructuring foreign economic relations

The purpose of the change introduced in the foreign economic relations sector in 1 January, 1987 is to provide for the more effective participation of the USSR in the international division of labour by restructuring foreign trade management, practices and procedures. The final goal is to transform the Soviet Union, the second industrial power of the world, from an exporter of commodities and intermediate products to an exporter of industrial goods and services.

Organizational changes include:

- (a) The establishment of a new 12-member Foreign Economic Relations Commission - a permanent body whose chairman reports directly to the Chairman of the Council of Ministers. The terms of reference of the Commission embrace:
- co-ordinating foreign economic activities, including trade, technology transfers, banking, insurance, transportation, tourism and cultural exchange;
 - overseeing legislation in the field of foreign economic relations;
 - conducting strategic planning of foreign economic activities.
- (b) The formation of the new International Economy Department in the Ministry for Foreign Affairs with a mandate to analyse world economic trends, assist Soviet economic and business agencies abroad, and co-ordinate

Soviet activities in the UN and other governmental international organizations;

- (c) The re-organization of the Ministry for Foreign Trade by transferring several foreign trade agencies (Stankoimport, Autoexport, Tractorexport, Energomashexport, Soyouzvneshstroyimport and others) to corresponding government departments.

Changes in procedures consist of two major innovations:

- (a) Granting the right of direct access to foreign markets to 21 Ministries and 75 large firms. This is an important reassessment of the notion of the State monopoly of foreign trade;
- (b) Formation of joint ventures with foreign partners - private or public sectors - for the production and marketing of goods and the provision of services. Foreign partners are allowed to hold up to 49 per cent of the equity, repatriation of profits or their re-investment in new commercial and industrial ventures in or outside the USSR is assured, as well as the repatriation of capital.

Agencies which have been granted the right of direct participation in foreign trade will account for about one-fifth of the total volume of export and import operations in 1987, including 40 per cent of trade in machinery and equipment. Altogether 40 joint ventures are expected to come into operation by 1988, including over 30 operations with socialist countries and the rest with capitalist ones (hotels with Finnish and Swedish capital, restaurants with Indian, fashion magazine with West German capital, women's garment and shoe factories, as well as chemicals,

information processing centres, flexible production systems, etc).⁵

III. Problems of Implementation

These fall under two headings:

In the Short-term, better use can be made of available resources by enforcing greater economic discipline, improving work ethics, and by adopting other organizational and managerial measures, which do not require additional investments. By utilizing these so-called "reserves" or "hidden reserves", returns have appeared right away. The national income rose in 1986 by 4.1 per cent as against 3.6 per cent average during the previous five-year plan period (1981-85), industrial production by 4.9 per cent, one-third higher than the average growth rate in the preceding five years and the, productivity of labour by 4.6 per cent as against the planned target of 4.1 per cent. These results are not negligible, but the effect of using reserves which are, so to speak, "on the surface" and thus easily exploited could be limited. Hence the importance of other policy instruments.

In the Long-term, by far the most important instrument of the new stratgy is the acceleration of technological advance. This is a complex task which requires restructuring and renovating the technological base of the economy, and, as was discussed previously, changing the economic mechanism. Contrary to what is sometimes said in the West, the present restructuring in the USSR is not a

⁵ For a more detailed discussion see: Vladimir Kamentsev. 'Restructuring in the USSR: foreign economic aspect', World Marxist Review, NG, 1987, pp.54-58.

retreat from socialism, but rather a comeback to it, to many moral and political values proclaimed by the 1917 Socialist October Revolution, but not realised for one reason or another. It is a substitution of one form of socialism for one which has historically exhausted itself.

'The main question in the theory and practice of socialism', Secretary General M.S. Gorbachev has said, 'is how to devise more powerful incentives on a socialist foundation for economic, scientific and technical, and social advance, than capitalism does, how to combine most effectively central planning and the interests of the individual and the community'.⁶

Constraints are evident. They are both external and internal. External constraints include (international tensions and the lack of progress in the arms reduction talks, COCOM and other discriminatory measures by Western governments related to export controls, the adverse effect of a cyclical development of the world economy, price fluctuations etc.). Internal constraints include (inertia, old ways of thinking, resistance to change, or simply inability to adapt to new conditions. The removal of these constraints will require considerable time and effort. What has been done so far is only the beginning. And there is no point in overstating it.

There is no open resistance to the reforms. Everybody agrees that they are necessary. But there is what may be called a passive resistance to change. Those whose privileges are directly threatened by the shake-up or those who have discovered that new ways of doing things require a lot more effort than the old ones do not hurry to change.

⁶ Pravda, June 26, 1987.

Some people believe that restructuring concerns everybody else but them; others simply have not yet found the right way of working in the new conditions. Such attitudes will take time to disappear and to leave room for new work ethics.

It is not pretended that final answers to the problems facing the USSR have already been found. Many long-awaited decisions have been taken. Many more will follow. Some of them work; others, as is already clear, do not and will have to be replaced by new ones. Economic reform is not a single act. It is a continuous process which, given a good in-built mechanism, has no final conclusion. To find the right answers is a complex task. To implement the decisions taken is even more difficult. There is no insurance against mistakes. Human errors are inherent in all systems - socialist and capitalist.

The programme of economic, political and social reforms put forward in the past two years is widely supported by the vast majority of people. They realise that it will provide the opportunity for the realization of their interests. They understand that there is no alternative to "perestroika" (the Russian word for restructuring or vigorous shake-up) and no alternative to 'glasnost' (openness), because without a critical appraisal of everybody's performance, there can be no guarantee that the changes will be irreversible. But the people are prepared to go to the end, and they welcome the key remedy proposed: the all-out democratization of society.