

Will Gorbachev's Economic Reforms Be Successful?

By Hisao Kanamori

The following article on the state of the Soviet economy is based on my personal observations during a visit to the Soviet Union from May to June 1985.

Gorbachev bent on promoting economic reform

With a leader as enthusiastic about economic reform as Mikhail Sergevich Gorbachev at the helm, I have little doubt that the Soviet economy will undergo a major transformation.

Since taking up the post of general secretary, Gorbachev has made numerous public speeches. In every one he has dwelt on two main themes: first, the need to make full use of the latest achievements in science and technology; and second, intensification of the economy. By economic intensification, the top Soviet leader has more in mind than merely expanding the scale of the economy. Of greater importance is improving economic efficiency in the use of raw materials, capital investments, and labor productivity.

There is nothing new about these targets. In fact, Leonid Brezhnev also hammered home these two points toward the end of his reign. Yuri Andropov, too, was enthusiastic about economic reform. Yet neither Brezhnev nor Andropov wrought any substantial change in the Soviet economy. Indeed, not a few experts on the Soviet economy are skeptical about Gorbachev's own ability to deliver. Some cynics have even dismissed his pronouncements on economic reforms as just the latest round of empty talk.

Such cynicism, I believe, fails to take into consideration the fact that economic development is as much a product of leadership as of the objective envi-



The Soviet Union's new leader, Mikhail Sergevich Gorbachev

ronment. Witness the vast economic changes that took place in Japan under Prime Minister Hayato Ikeda (1960-64), in the United States under Ronald Reagan, and Britain under Margaret Thatcher. All these political leaders breathed new vitality into the economic systems of their respective countries. There is, therefore, little reason to doubt that the Soviet economy too will respond to the strong leadership of the reform-minded Gorbachev.

Internal conditions within the Soviet Union have changed since the deaths of Brezhnev and Andropov. First, the Soviet people are getting impatient; second, Gorbachev is taking a fresh approach to promote economic reform; and third, he has the means to do it.

Before going any further, let us examine current Soviet economic trends. Compared to developed economies in

the West, the Soviet Union did comparatively well in terms of economic growth between 1975 and 1984 (see chart). Taking 1975 as a base, the Soviet economy grew by 40% over the ten-year period, a growth rate topped only by Japan's 50%. The Soviet pace of growth exceeded that of the United States, West Germany and Britain. Besides, unlike the United States and several West European countries, the Soviet Union did not record minus growth during the period. Although somewhat sluggish, the pace of Soviet economic growth has been remarkably steady, resulting in considerable expansion over the period.

Admittedly, it is a rather futile exercise trying to draw direct comparisons between Soviet and Western GNP's since they use such different yardsticks in computing the figures. Nonetheless, it is erroneous to suggest that the Soviet economy is in crisis, or that the Soviet people are bursting with dissatisfaction and malcontent over their own economic well-being. Far from this gloomy picture which some Western observers draw, it is evident that the living standard of the Soviet people has been going up every year. In their own ways, the Soviet people do enjoy their livelihood.

This is not, of course, to say that the Soviet economy is free of problems. In fact, quite the reverse is true: the Soviet Union is plagued with major weaknesses in its economic system.

Sources of discontent in the Soviet economy

In his speeches, Gorbachev has been highly critical of the way the Soviet economy is functioning. I think the Soviet leader is particularly vexed by two problems.

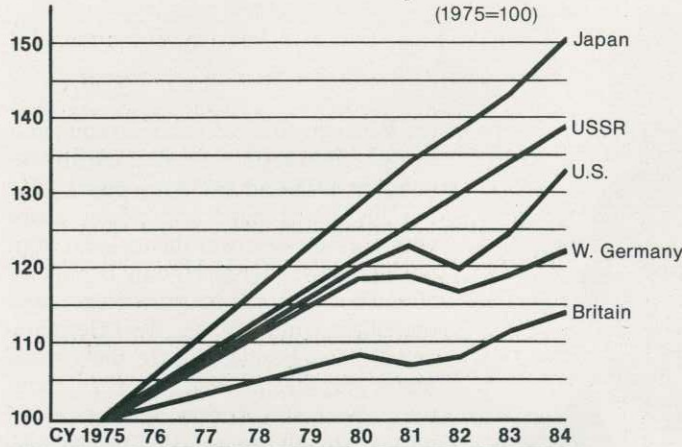
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Table 1 Trends of Major Economic Indicators in USSR (percentage increase over previous year)

| | (1971-1975: 9th five-year plan) | (1976-1980: 10th five-year plan) | | (1981-1985: 11th five-year plan) | | FY 1983 | | FY 1984 | | FY 1985 |
|-------------------------------------|---------------------------------|----------------------------------|-----------------------|----------------------------------|------------------------|---------|--------|---------|--------|---------|
| | Actual annual average | Planned annual average | Actual annual average | "Basic direction" annual average | Planned annual average | Planned | Actual | Planned | Actual | Planned |
| National income (expenditure basis) | 5.1 | 4.7 | 3.9 | 3.4-3.7 | 3.4 | 3.3 | 3.1 | 3.1 | 2.6 | 3.5 |
| National income (production basis) | 5.7 | - | 4.2 | - | - | - | - | - | - | - |
| Total industrial output | 7.4 | 6.3 | 4.4 | 4.7-5.1 | 4.7 | 3.2 | 4.0 | 3.8 | 4.2 | 3.9 |
| of which, production means | 8.2 | 6.7 | 4.7 | 4.7-5.1 | 4.7 | 3.1 | 3.9 | 3.7 | 4.1 | 3.9 |
| of which, consumer goods | 6.5 | 5.7 | 3.9 | 4.9-5.2 | 4.8 | 3.5 | 4.3 | 4 | 4.3 | 4 |
| Total agricultural output | 2.5* | 3.0* | 1.7* | 2.3-2.7* | 2.5* | 10.5 | 5 | 6.4 | 0.0 | 6.7 |

Note: Asterisk denotes annual values of averaged growth rates in previous five-year plan.
Sources: USSR National Economy Statistical yearbooks for years cited, 1983 edition of "A Look at the Soviet Union from Figures," *Pravda, Economic Daily*, and others

Economic Growth Rates for Major Nations



Notes: Based on statistics released by individual countries. The Soviet figure is based on total output of goods.

Table 2 Per Capita GNP (1983) (unit: \$)

| Socialist countries | | Capitalist countries | |
|---------------------|-------|----------------------|--------|
| E. Germany | 9,270 | U.S. | 14,120 |
| Czechoslovakia | 7,850 | Canada | 13,130 |
| USSR | 6,765 | W. Germany | 10,690 |
| Hungary | 6,710 | Japan | 9,700 |
| Bulgaria | 6,040 | France | 9,410 |
| Poland | 5,800 | Netherlands | 9,260 |
| Yugoslavia | 5,365 | Britain | 8,020 |
| Romania | 4,850 | Italy | 6,250 |
| China | 335 | | |

Note: GNP for socialist countries is calculated in terms of U.S. purchasing power.
Source: CIA, Handbook of Economic Statistics, 1984

Gorbachev is singularly disappointed with the government's apparent inability to fulfill the state's current five-year plan. Table 1 indicates that the real growth of the Soviet economy has been losing momentum. For the 11th five-year plan (1981-85), state planners from the outset set a relatively modest growth target of 3.4%. But in both 1983 and 1984, actual growth fell below even these low targets, recording only 3.1% and 2.6% respectively.

The second cause of Gorbachev's disappointment, I imagine, is the lackluster performance of the Soviet economy compared to countries in the neighboring socialist bloc. East Germany is one example, and China another.

In East Germany, as I observed in a visit prior to my Soviet trip, there are ample signs of economic growth. Indeed, after recording 4.4 percent net economic growth in 1983, the East Germans chalked up 5.5 percent growth in 1984. The economy grew again by 5%—in annual rates—in the first four-month period of 1985.

Economic growth in China is even more spectacular. Agricultural and industrial production rose by 10.2% in 1983 and recorded 14.2 percent growth in 1984. No wonder Gorbachev is disappointed with the economic performance of the Soviet Union, the cradle of socialism.

The Soviet leader is not alone in his desire for economic reform. In all likelihood, the Soviet people themselves feel the need for change, especially today when an increasing number of Soviet citizens travel to the COMECON nations and can see with their own eyes the higher standards of living there.

Average personal income in the Soviet Union lags far behind that of East Germany and Czechoslovakia (Table 2). According to statistics compiled by the American Central Intelligence Agency (CIA), per capita GNP in East Germany stood at \$9,270 in 1983, the highest in East Europe and roughly the same level as in Japan. In Czechoslovakia, per capita GNP in 1983 was \$7,850, against only \$6,765 in the Soviet Union. Even to the casual traveler, it is obvious that consumers in East Germany are much better off than in the Soviet Union. There is no doubt that these travelers will return home with serious questions about the government's economic policies.

To Gorbachev, the prevalent mood for change within the Soviet Union can work to his advantage. At 54, this youngish-looking leader must have been a welcome change to the Soviet people after long years of gerontocratic rule under Brezhnev, Andropov and Chernenko. The fortuitous timing should help reduce ini-

tial resistance to Gorbachev's reform program and strengthen its public support.

Three areas of reform

The problems of the Soviet economy can be explained in classic Marxist terms: the contradiction between productive forces and productive relations has caught up with the Soviet economy.

When the level of economic activity in a given country is still relatively low, it is possible for the government to come up with effective plans and operate the economy by fiat. Under such circumstances, a centralized planned economy can work quite well. However, when the economy becomes more developed, a centralized system can no longer cope with its structural complexities and diverse consumer needs. The methods of economic management must be changed—a fact that should be evident to any traveler who has seen the Soviet economy in action. Wherever one goes, the souvenir shops display exactly the same kind of products: amber-made necklaces, phonographic records, wooden dolls, lacquered bowls, and perhaps some glass products from COMECON countries. Although consumer tastes differ in a thousand and one ways, Soviet suppliers apparently do not bother to cope with changing de-

mand. Year in and year out, the stock remains the same. Without a change in the economic structure itself, all calls for economic intensification and promotion of science and technology are nothing more than hollow invocation.

However, I have a feeling that under Gorbachev things are going to change. He may even call in the technocracy to carry out economic reform.

About the necessity of reform there seems little disagreement among Soviet economists. Indeed, many of them have long urged the government to overhaul the structure of the economy. Unlike his predecessors, Gorbachev appears to be the kind of man who can feel at ease with technocrats—like President John F. Kennedy, who surrounded himself with economic gurus the likes of Paul Samuelson and James Tobin.

The noted Soviet economist, A.G. Aganbegwan, may be such a man. He heads the Economics and Organization of Industrial Production Institute in the Siberian town of Novosibirsk, which became famous two years ago after it published a secret report highly critical of the Soviet economic system. I had a chat with Aganbegwan last year during a trip to Novosibirsk. Although I could not confirm it at the time, Aganbegwan is reputed to be part of Gorbachev's brain trust.

This year, I also discussed the state of the Soviet economy with Soviet economists Dr. Vladlen A. Martynov and Dr. Ivan D. Ivanov, both deputy directors of the Institute of World Economy and

International Relations, Academy of Science of the USSR. The impression I got from these talks—together with an analysis of Gorbachev's speeches—indicates that three areas of economic reform are now under way in the Soviet Union.

Decision-making by the enterprise

The first is an attempt to give more autonomy to state enterprises. Under the planned production system, the government first sets forth targets for volume and product quality as well as numerous other objectives, and then assigns these tasks to specific enterprises. In the future, it is said, the government plans to cut the share of planned production by giving more weight to normative planning. Normative planning naturally differs from target-oriented planning. Under normative planning, the management of one particular business would be given—within certain bounds—discretionary power to use its funds the way it sees fit, whether for paying wages, buying raw materials, or capital investment. It is expected that this system will induce management to work harder to cut production costs.

Another aspect of reforming the state enterprise system is to encourage greater use of contracts. Instead of relying on government allotment, enterprises are encouraged to buy the raw materials they need from other enterprises through the use of contracts. For consumer products, enterprises are being encouraged to take orders from retailers instead of relying on state instructions. Specifically,

manufacturers are now told to tailor their output, as well as the quality and design of their products, to consumer needs. Enterprises have also been encouraged to expand the scale of industrial complexes in order to minimize the need for state intervention. There is even an attempt to decentralize power in the production of consumer goods, by giving more responsibility to local authorities and various Soviet republics.

Labor incentives and productivity

The second aspect of economic reform involves boosting labor incentives. Here the focus is on improving the pay system, and recommendations include linking pay to productivity and wider use of bonuses. But the idea of productivity-linked pay goes beyond individual workers. There are also suggestions to form small worker groups and link pay to the entire group. This is particularly true in the case of farming. There are reports that in some areas groups of farm workers—ranging from five to thirty people—have been contracted to undertake production.

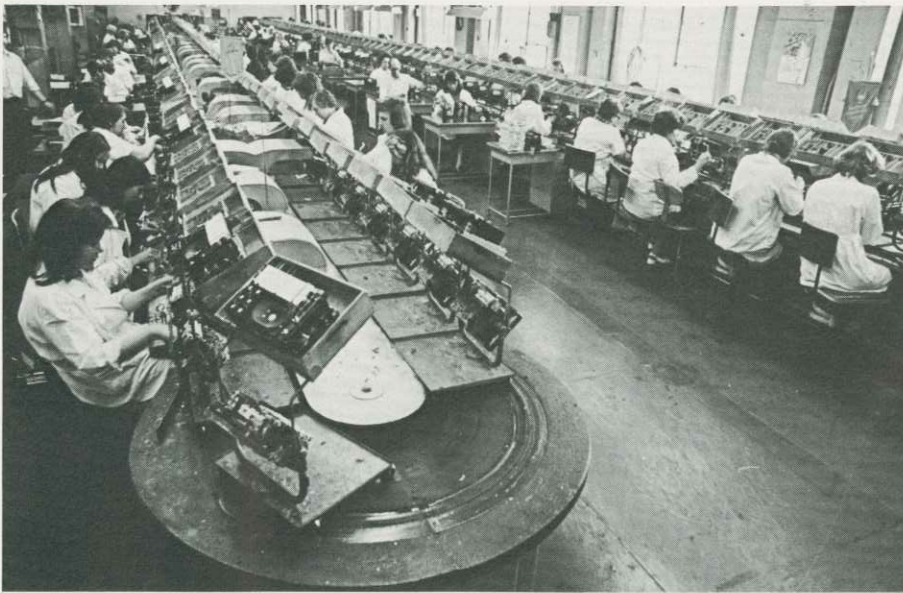
In the Soviet Union today, farming is primarily carried out under the so-called Kolkhoz system, and productivity is far from desirable. By contrast, agricultural production in China is said to have gone up by leaps and bounds after the Chinese government abolished the commune system and replaced it with a contractual approach. Of course, it would be unrealistic to expect the Soviet government to carry out such a drastic reform of its own agricultural sector. Still, there is no denying that the contractual system will increasingly prevail in the Soviet Union, too.

One interesting aspect of Soviet attempts to bolster labor incentives is the move to improve consumer goods and services. This became evident in the 11th five-year plan, in which the Soviet leadership shifted the thrust of economic planning from the means of production to consumer needs. This trend is not expected to change in the 12th five-year plan.

Soviet authorities are also said to be building more sightseeing and leisure facilities as part of government efforts to boost consumption incentives. The savings rate in the Soviet Union is extremely high, but most savings are involuntary, the result of insufficient outlets for spending money. If you can't use the income you earn, there is little incentive to work harder to earn more. It is presumably out of such reasoning that the Soviet authorities are stepping up efforts to expand the range of consumer goods and build more recreational facilities.



Prices of most foodstuffs have been frozen for more than 20 years, but flexible pricing is now being considered.



Boosting labor incentives to achieve growth is a key to current economic reforms.

Prices that reflect reality

The third area of economic reform now underway in the Soviet Union is an overhaul of the pricing system.

Prices in the Soviet Union have remained unchanged for years. Retail prices of most categories of foodstuffs, for instance, have been frozen for more than 20 years, and there has been no price increase for meat and milk since 1962. The prices of bread, most varieties of fish, table grains, sugar, and edible oils have not changed since 1955.

Most people in the Soviet Union regard this as a sign of the strength of a socialist economy. However, the conditions of production and the pattern of consumer demand have shifted dramatically over the years, and a static pricing system is most unlikely to provide an appropriate yardstick for the economy to function smoothly. It seems that Soviet authorities are beginning to grasp the reasoning behind this argument, and realize that it is basically wrong to maintain the same price over many years.

According to Martynov, of the Institute of World Economy and International Relations, Soviet authorities are now studying a new pricing structure. One plan under consideration, he says, would introduce a flexible pricing system in the next five-year plan that reflects the productivity of individual enterprises, subject to adjustment every two or three years.

Basically, the current Soviet pricing system is based on a cost-plus-profit formula, with the government keeping retail prices from rising through subsidies. Such a pricing system deprives management of any incentive to rationalize pro-

duction, as the state continues to prop them up through ever-expanding subsidies. The resulting low prices lead to excessive demand for some products. For instance, the long queues formed in front of meat shops do not necessarily reflect a shortage of meat, so much as the failure of the pricing structure to do its job.

There are, of course, problems with raising prices. For one thing, the Soviet people have long been used to stable prices, and any attempt to mark them up now would surely trigger vast discontent among the masses. Besides, higher prices may also trigger demands for pay raises and set off a chain reaction throughout the entire economy. Hence, some people are rather pessimistic about the chances of reform in pricing.

However, the plain truth is that the prevailing pricing system in the Soviet Union is totally irrational. Of course, Soviet authorities have been trying to ease the situation, as illustrated by their decision to encourage the development of a free market for agricultural products. Gorbachev himself has called for fundamental revision, saying: "Without fundamental improvement in the pricing system, it will be impossible for us to implement our economic policies for introducing new and progressive elements into our economy." With Gorbachev taking the lead, what had previously only been a subject of discussion among academics has now become a pressing policy task.

Good chance for success

Indeed, Gorbachev takes economic reform very seriously. In the past, discussions of economic reform tended to go

nowhere because of bureaucratic opposition. For the Soviet Union does have a bloated bureaucracy, and one bent on protecting its vested power and interests. In fact, one aim of Gorbachev's reform measures is to slash the size of the government's supervisory organs.

Another Gorbachev initiative takes on yet another die-hard issue: alcoholism. On June 1, the government issued orders banning the use of alcoholic drinks at government, business, and school functions. Anyone caught drunk in a public place is liable to be reprimanded or fined between 20 and 30 rubles (\$16-24 at the exchange rate of \$0.8/Rub1). Those found drinking in the office or showing up with a hangover when they report for duty are fined 30-50 rubles. And sales of alcoholic drinks are banned until 2 p.m.

There are doubts whether such stiff liquor laws can be sustained. I, for one, have strong reservations because it seems to me that the Soviet people can't do away with liquor. On the other hand, if the Soviet people were able to stay away from vodka and dedicate all their energy to work, then Soviet economic growth would surely rise at a stupendous pace.

All in all, there is a clear difference between the current wave of reform initiatives and previous attempts. The signs are that Gorbachev has a good chance of success. His age, too, will work in his favor. People expecting a long rule will not be likely to oppose his wishes. With time on his side, Gorbachev can afford to move slowly and cautiously.

The current reform is only gradual and not radical, as was that in China. The Chinese seem determined to weave the principles of a market economy into their socialist economic fabric and drive the economy through the market mechanism. It is different in the Soviet Union. Even when the Soviets say they are giving more autonomy to the managers of enterprises or are changing their pricing system, what they have in mind is simply to make the planned economy work more efficiently. Gorbachev made this point clear when, in a speech delivered last June, he said that, "We must move toward the direction of further strengthening and developing democratic centralism."

In other words, centralist economic control and planning are here to stay in the Soviet Union. But at the same time, every effort will be made to improve economic efficiency through allocating more discretionary power to enterprises, loosening supervision by the state, and introducing an independent profit accounting system. ●