

## Gorbachev's Economic Reforms in the Context of the Soviet Political System

Stanislaw Gomulka\*

Since the Spring of 1985 a warm wind of change has begun to envelop the Soviet Union. The social temperature has already increased far enough to raise the hopes of some, and the eyebrows of others, that the 'icy heart' of the country's immensely centralized institutional structure may soon begin to melt. This institutional structure has changed remarkably little since the 1920s and the 1930s. It was established to serve the implementation of a new social order by a relatively small group of single-minded revolutionaries in a political environment, initially, at least, very much hostile to it and, therefore, in a manner exceptionally unpleasant for a large number of the Soviet people. That manner changed much for the better after Stalin's death in 1953. However, Khrushchev's de-Stalinization process was effectively stopped when Brezhnev came to power in 1964.

In the meantime the peasant-dominated country of 1928 had been transformed into a fairly modern one, becoming in the 1950s a large industrial power and, of course, a military superpower. The people, the post-war generations in particular, have become well-educated, especially in the sciences and technical subjects, relatively well-informed and generally fairly sophisticated. These social changes, as well as higher real incomes, have bred tastes for high quality consumer goods, travel abroad and a meaningful participation in the country's social, economic and political life. But these new, higher order needs are precisely those which the old institutions and policies were designed to limit or suppress. The pressure for changes in these institutions and policies was thus building up for some time.

However, what gave special urgency to these changes now was, I think, not this pressure from below, which seems still to be moderate and containable, but a sense of crisis at the top. This crisis was caused by a sharp fall in the rate of Soviet economic growth to, approximately, the magnitude of the US rate. This fall came in the mid-1970s, at a time when the

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\*Department of Economics, The London School of Economics and Political Science, London, England

levels of Soviet national product and consumption per person still remained much below the US levels. Subsequent desperate attempts to increase the growth rate and revive the process of economic catching-up have so far failed, and the failure has raised the spectre of the standard of living in the socialist USSR remaining visibly and indefinitely below that in the capitalist West. If that was accepted as inevitable, the attractiveness of the Soviet social system, both at home and abroad, would be put at a serious risk. The sense of crisis among the Soviet elite has been additionally compounded by an even sharper slowdown in economic growth in other socialist countries of Eastern Europe, by the countries' rather large debts to the West, and by massive demands for liberalization and full citizenship rights in Poland. Furthermore, the US "Star Wars" programme has brought home the point that a permanent technological gap may also involve a high security risk.

Given this background, significant new initiatives by any post-Brezhnev leadership should have been expected. The changes initiated by Gorbachev, however, appear to be faster, deeper and wider than most Soviet and outside observers anticipated. The new General Secretary immediately startled his fellow citizens by being unusually frank and outspoken about the problems he and they have inherited. To cure them, he insists, a deep and comprehensive *perestroika* (institutional 're-structuring' or 're-organisation') is an urgent necessity for the USSR. Radical economic decentralization is to be a vital part of that restructuring. Political democratization, apart from being good in itself, is also to be a key instrument of, and a necessary condition for, successful implementation of that economic reform. A number of questions immediately arise. What is to be the content of these intended reforms? Are they feasible? Do they put into question the standard Western view of limited reformability of the Soviet system? What are the major obstacles to such reforms? Given the presence of these obstacles, what actual impact are the attempted reforms likely to have on the USSR and Eastern Europe? These are some of the major questions which are now being widely asked and discussed throughout the world, above all in the Soviet Bloc. An attempt to provide preliminary answers to them is the subject of this article.

### **I. Economic Reforms: What They Are or Are Likely To Be**

Two laws under the proposed reform programme were adopted already by the crucial June 1987 Central Committee meeting which dealt specifically with the program. One concerns individual (private) enterprise (November 19, 1986) and the other foreign trade organizations and joint

ventures (January 21, 1987). An important draft document on state enterprise was published in February 1987 and has since been the subject of national debate in the mass media before the Supreme Soviet turned a version of it into law on June 30, 1987. In preparation is a new law attempting to redefine the role of the central economic institutions. Its thrust will be to limit the executive powers of the State Planning Commission (Gosplan) and the State Supply Organization (Gossnab), the two main pillars of the present system, and to widen the role of the central bank and the ministry of finance. The provisions of these two laws, on state enterprise and the economic centre, are crucial for defining the content of the whole reform. They have been hotly debated within the inner circle of the government and its economic advisers in the course of 1986 and the first half of 1987. Their approval in principle by the June 1987 Central Committee meeting opens the way to substantial changes from 1 January, 1988, with the intended full implementation by 1 January, 1991.

Although many specific arrangements are yet to be decided, a preliminary overview of the proposed reform may be formed. Firstly, the reform is to be substantially more than (as was often the case in the past) a mere reorganization of central planning, incentives and decision-making within an essentially unchanged, highly centralized economic system. Secondly, the reforms will be introduced gradually over the years 1987-1990, rather than at one go, as in Hungary (January 1968) or Poland (January-February 1982). Their provisions are still set to ensure that many important products and investment projects will continue to remain under direct central control. However, a substantial part, perhaps the bulk of that part of the economy which is producing marketable goods and services, would be decentralized and, at least to some extent, subjected to the discipline of the market. That market-responsive part of the economy would typically be free of any direct government intervention; it would instead be influenced indirectly, by means of centrally imposed or regulated incentive schemes, imposed prices or price formation rules, exchange and interest rates, fiscal measures, etc.. Thus a regulated market is now seen by Soviet reformers to be capable not only of performing the usual job of inducing individual producers and consumers to make appropriate allocative choices, but also as a medium through which the centre would affect those choices in the "socially desirable" direction.

In other words, central planning and the market are regarded as reconcilable. The idea as such is not new. It has, in fact, been promoted by economic theorists of market socialism, such as Taylor, Lange, Lerner, Brus and Kornai during the last half a century. In the present (imperfectly) directly centralized system of the Soviet economy, markets do already

play significant role. But it is now admitted that a market-directed socialist economy requires a far greater decentralization of decision-making to enterprises than at present, as well as the abandonment of centrally-imposed plans for enterprises. Under the proposed system the centre may still hope and attempt to "manage" the market to such an extent that the managerially and financially independent enterprises would be supplying, and the consumers would be demanding, the types and quantities of products which the centre either desires or, at least, does not object to. Whether the market can perform well in its efficiency-enhancing and plan-implementing roles, is another matter, although one of crucial practical importance. Be that as it may, the Soviet economy under the new system would bear a strong resemblance to the Hungarian economy under the New Economic Mechanism (NEM), although probably retaining more elements of the old system than the NEM has retained. A reform of this type aims to improve allocative efficiency, induce innovation, increase exports to competitive dollar markets, and reduce shortages at home.

But there is an important caveat. The purely economic gains are to be achieved without excessively compromising both the traditionally socialist principles of full employment and a low economic (income and wealth) inequality and the communist principle of retaining the pre-eminence of the economic and political preferences of the centre. The reformers admit that competitive markets in the West have in practice proved able to impose a more effective discipline on enterprises than can Soviet central planners directly. This practical experience is indeed the major reason for the reform. But the central planners wish to secure the allocative benefits of that greater disciplinary effectiveness of the market, while, at the same time, still striving to retain for themselves the role of the dominant economic actors and to ensure in this way that social and long-term interests are given adequate weight.

The specific reform measures which are to be adopted in the USSR are therefore of two categories. One category consists of measures designed to promote economic efficiency and industrial democracy. Most prices are to be market-influenced, enterprises are to be largely self-financed, bankruptcies are to be allowed and, most managers are to be appointed by the workers themselves. These measures are intended to promote improvements by making positive (material) incentives stronger and negative ones (threats) more credible. They are also intended, through the use of 'realistic' prices, to make economic performance more transparent. The second category consists of measures of direct influence. Many key inputs, such as foreign exchange and investment credit, will continue to be centrally allocated, most wages and prices will remain subject to central

control or regulation, large subsidies and taxes will be used to avoid unemployment and to keep economic inequality low, managerial appointments will need approval by party committees and ministries. The empirical evidence from Hungary and Poland suggests that systematic features of the second category lead to bargaining between state enterprises and the centre so wide spread as to fundamentally weaken the efficiency measures of the first category, rendering the latter almost completely ineffective. A different outcome in the USSR seems unlikely.

In China and Hungary it is largely in the private sector and, to some extent, in the more competitive segments of the non-private sector, where the reforms have been an unambiguous success. Soviet reformers, however, apparently do not intend to follow the Chinese and the Yugoslavs in permitting the dissolution of state cooperative farms and the return to private farming on a large scale. The reasons are probably mainly ideological, although the Soviet economists to whom I spoke this Spring stressed the difficulties in selling or renting to individual farmers large buildings and expensive machinery, of which there is in Soviet agriculture much more than was the case in the Chinese communes. Less radical measures are being urgently considered. Some of these are already being implemented, including giving the farms the right to decide what they are to produce. Farm managers are also allowed to split their cooperatives into separate accounting units to be run by self-selected teams, such as individual families, in order to establish a clear link between work and pay.

A major headache of the Soviet society is the services sector. It is hoped that the recently adopted law on "individual labour activity" will bring a major improvement in this particular area. The activities permitted under the new law include making of clothes, shoes, carpets, furniture; building and repair of dwellings, servicing of durable consumer goods, teaching school or university subjects and providing medical services. However, it is interesting that the hiring of labour by individuals remains strictly illegal. State employees may indulge (with some exceptions) in private activity only in their free time. The law forbids the making of duplicators or photocopiers, presumably to hinder the spread of *samizdat* publications. It also forbids the teaching of subjects not included in the official curriculum of any state education establishment. The rate of tax, at 60 percent of any private income in excess of 25,000 per annum, seems to have been set to impose a fiscal constraint as well on the growth of the private sector.

## II. Why Has the USSR Moved in This Direction?

The official case for a "radical reform" of the Soviet economic and political system has been developed by Gorbachev and his close associates and advisers over a period of five years or so, but articulated openly only during the last two or three years. Perhaps the most intellectually interesting are Gorbachev's Reports to the Central Committee of the Soviet Communist Party on January 27, and June 27, 1987. These reports are in many ways as critical of the post-Stalin economic and political system as is most Western analysis.

Gorbachev's case rests primarily on the evidence of a substantial economic and technological slowdown of the Soviet and East European economies since about 1975, a phenomenon which I have already mentioned. Although in 1928 the USSR entered the economic race with the capitalist West from an inferior starting point, the political legitimacy for the new communist elite was derived to a large extent by the success in achieving high growth rates in the years 1929-41 and 1947-75, raising hopes that the USSR could achieve the highest standard of living in the world. Such achievement would substantiate the crucial ideological claim of the inherent superiority of the Soviet social system by using the Soviet's own criterion.

The slowdown came at a time when the USSR reached, in per capita terms, only about 40 to 50 percent of the US Gross National Product and about one third of the US level of consumption (and about a half of UK consumption). These data may be disputed on a number of grounds. In particular, they do not reflect adequately the poor quality of Soviet products. The welfare of the Soviet citizen is, on the other hand, increased by high job security and also, perhaps, by a fairly high degree of equality, but is reduced on account of highly limited choice and long queues at shops. Given the inferior starting point, the data may be regarded as evidence of very considerable economic success. The problem, however, is that since 1975 the relative position of the USSR, in terms of these two key macroeconomic indicators, has been practically stable. It is true that since 1975 an economic slowdown has occurred also in Western European countries and Japan. However, the rates of innovation in these countries continue to be sufficiently high to bring about eventually a total or nearly total elimination of the per capita consumption gap with the USA, a gap which in any case is already relatively small.

As a consequence of these post-1975 developments, Gorbachev and his colleagues are now haunted by the possibility of the developed market-

based economies of the capitalist West retaining a considerable advantage in technological levels and a large one in the standard of living. Soviet leaders and economists have begun to notice with disgust that the aggregate dollar purchasing power of the USSR and Eastern Europe, given by their dollar exports, is about the same as that of Belgium and Luxembourg. They are especially concerned by the Soviet and East European exports of manufactured goods, including military equipment, remaining embarrassingly insignificant despite a major effort to increase them. These exports are now lower than, to give an example, similar exports by South Korea alone. The political crisis in Poland in 1980-83 and the recent Western challenges in military technology have also served notice that the economic weaknesses of the Soviet type system may have potentially grave implications for the internal political stability of the Communist Commonwealth and the realism of Soviet worldwide aims.

The main purposes of Gorbachev's reforms must be for the USSR to regain enough its internal dynamism to resume economic catching up to the developed West and for Soviet people to sustain (or regain) their confidence in the Soviet communist system. He seems to be taking the view that the unceasing waves of Western new inventions in the form of attractive consumer products, especially those which the Soviet economy cannot produce quickly or does not produce at all, are constantly putting to test the patience of the Soviet consumer, undermining as a result the credibility of socialist efficiency claims and feeding the inferiority complex of the Soviet worker. In the modern world of mass communications and ease of travel, these effects are not easily tolerable and in a long term may even be potentially dangerous for the Soviet political system. Reaching military parity with the USA was a major goal that has been achieved. But in the expected absence of a war involving the two superpowers, the significance of this great achievement begins to fall, and the interest of the Soviet population must therefore begin to shift more and more to comparative achievements in economic and cultural domains. The question is whether Gorbachev, like the reformers in Hungary, Poland and Yugoslavia before him, does not expect too much from too little.

### **III. Major Political and Social Obstacles to Reforms**

In his plenary report of January 27, 1987, Gorbachev himself admitted that "change for the better is taking place slowly, the cause of reorganization is more difficult and the problems which have accumulated in society more deep-rooted than we first thought". On another occasion he nevertheless dismissed the thought that there is an internal political

opposition to his proposed reforms in the leadership, the party and the government apparatus, or the society at large. The opposition to reform exists but the reasons for the opposition are, according to him, only psychological rather than political or social. Gorbachev suggests that intellectually everyone is convinced of the merits of *perestroika* and therefore is in favour of it, but due to the force of old work habits, everyone, himself included, is also against it (see his address at the April 1987 Congress of Soviet Komsomol). There may be a grain of truth in this view, but it cannot do for a satisfactory analysis. It is also a rather strange view to hear from someone who is supposed to think in terms of group interests and of social responses depending largely on how these interests are or are expected to be affected by any change.

The subject of obstacles to reform under Soviet-type socialism is both complex and fascinating, but not particularly well researched, partly because it has until recently been strictly forbidden, for Soviet and East European social scientists, to investigate them. However, the history of reform attempts is rather long, and in its course a significant body of helpful analysis and evidence has been produced.

The obstacles most widely stressed as major are political and social. A reform based on marketization of the economy and decentralization of decision-making does imply a considerable redistribution of political and economic power. The potential losers are the central and intermediate levels of economic administration: Gosplan, Gosstrib, branch ministries and industrial associations. Some of their decision-making powers are planned to be diffused to enterprises and some other to be taken over by financial central institutions, such as the ministry of finance and the central bank. The top decision-makers, the Politburo and the apparatus of the Central Committee, will of course continue to be in the overall charge of the economy. They intend to reduce the power of subordinate ministries, substitute a rather ineffective bureaucratic discipline of enterprises for the hopefully more effective discipline by the market, and keep for themselves key allocative and policy decisions. In this way the top centre may justifiably hope to improve control over the performance of the major segments of the economy. This top centre also stands to gain politically at home and abroad from the beneficial impact of economic reforms on allocative efficiency, on the choice and quality of goods and services, and on innovation. On the other hand, the centre may lose some power, or a sense of power, when it abandons making detailed resource allocation decisions in favour of wider use of indirect (parametric) instruments and markets. However, this potential loss may be dismissed as of minor significance if the economy is not responding well anyway to the wishes of



the centre, which appears to be the present Soviet predicament.

There is still another potential loss that has to be considered carefully. It is related to the effects any substantial economic decentralization and marketization may have on the internal stability and, indeed, the survival chances of the traditional, one-party political system. The top leaders have to ask themselves whether the reforms or their absence entail greater risks of such an ultimate category. The answer to that question is only in part influenced by the political standing of the Communist Party, which tends to be higher in countries in which it came to power through internal revolution, as in the USSR, China or Yugoslavia. The issue is rather complex, since sometimes the communist leaders regard reforms as a means of winning political support, as apparently was the case in Hungary and Poland, and sometimes a wide measure of support is seen as helpful or even necessary before political risks of reforms can be accepted. Soviet leaders must find comfort in the fact that the political position of their communist party is overwhelmingly dominant in the country, and that the two-million nomenklatura group controlling all the key hierarchies of the party, economy and the state is well disciplined, prepared to trust and follow their leaders almost instinctively at nearly every turn. Still, in the present-day USSR much power is diffused throughout all levels of the large hierarchies and, therefore, the attitude of the whole nomenklatura group to the policies of the centre may be expected to have a major influence on the effectiveness of these policies. A strongly negative attitude to reforms would therefore be a major obstacle to their successful implementation, possibly sufficiently important to encourage dangerous splits within the leadership itself.

Gorbachev and his allies, in order to succeed and survive, must build effective defences around their "revolution from above", and be in a position to crush that potential obstacle in the form of a 'silent opposition from within'. Their policies of less secretive government (*glasnost*) and some limited political democratization may be interpreted as weapons of such defence. Its primary aims are twofold. One is to win over for the reforms a wider strata of supporters, especially amongst the party activists and the party rank and file, but also among the young and the talented outside the party. The other aim is to encourage these supporters to become the messengers of the new gospel and to form action groups pressing for appropriate changes at places of work throughout the country, from enterprises and farms to universities, the mass media and the military. The nomenklatura group would as a consequence be put under pressure from both above and below. (For a description of the group, its selection and functions, see a review by Peter Reddaway in *LSE Quarterly*, March

1986). The political campaign of *glasnost* and democratization would help the top leaders to mobilize, discipline and renew their cadres, and through the cadres, the society itself. The campaign may superficially seem inconsistent with the old doctrine of 'democratic centralism', but is in fact only a novel way of implementing this doctrine, which, Gorbachev states, remains very much in force. The novelty is in that the mass media are instructed to not only say what the new reform ideas are, but also make a fairly serious attempt to discuss them openly and to provide convincing motivation and arguments for the reforms. Providing such motivation and inviting discussion is now seen as important in a society which is well informed on internal problems and well educated. Any political leader who aspires to win and hold a good measure of support from such a modern and fairly sophisticated society must now be considerably more open and more truthful than his predecessors ever needed to be. An inexpensive way to gain trust is to allow writers and historians to reveal some of the hidden truth about the Soviet's murky past. But Gorbachev probably feels that he also needs to be much more truthful about the present. This is usually a luxury, but one which in the first years of his rule he can easily afford to offer.

Winning a wide political support for economic reforms may still prove an exceedingly difficult task. The reform, when it begins to be effective, is likely to bring benefits to the skilled, the enterprising and the industrious. Since the reform measures are to be phased in gradually, they cannot be really effective in the short run, and possibly not in the medium term either. The medium-term expectations of its potential supporters are therefore quite likely to be frustrated. These supporters are an elite of a sort and hence probably a numerical minority. Suppose it is true, as alleged, that the majority of Soviet workers work poorly in inefficient enterprises. Many of these workers may fear the consequences of being left at the mercy of high uncertainty concerning incomes, prices and possibly jobs. A high rate of inflation was, indeed, a first major effect of reforms in other socialist countries. Some of the negative expectations are therefore likely to be confirmed.

Any economy, whether centrally-planned or market-based, is too complex to be really well understood. Consumers, producers and planners operate and take decisions in an information environment in which a great deal of data needed for the decisions are either false, missing, or uncertain. The decisions themselves are influenced by both economic considerations and cultural and institutional factors, and their separate influences are virtually impossible to identify. It is therefore not surprising that different economists tend to have very different predictions as to how

a centrally-planned economy such as the Soviet one, may respond to a particular reform measure. This wide variation in predictions is causing political decision-makers to be cautious, to prefer testing ideas one by one or in small packages rather than imposing large changes at one go and risk chaos of uncertain duration and cost, even if a desirable order of things would be highly likely to emerge from it in the long term.

Unfortunately for the practitioners of this evolutionary approach, modern economies are so intradependent that they have to be (more or less) consistent internally in order to function well. Command-type economy and competitive market mechanism are two such consistent systems. Testing small changes within each of them may therefore be a deficient way of seeking an improvement, since each system tends to reject any change which is characteristic of the other system. For example, French enterprises tend to ignore national (indicative) plans, whilst Soviet enterprises have tended to respond little to changes in prices and to ignore the self-financing principle. An evolutionary reform of a centrally planned economy therefore cannot be effective unless and until the package of market solutions begins to exceed what in Eastern Europe has come to be called a "critical mass". It is not clear precisely what reform measures the critical mass must contain. But the analysis of reforms in Hungary and Yugoslavia, and certainly in Poland, suggests that these countries have not yet reached that point on their reform paths. In fact, it would appear that a truly reformed, competitive socialist economy differs only very little from a capitalist market-based economy, except that, under socialism, the private sector employing hired labour, while large, would not be dominant an institutions of industrial democracy at the enterprise level might in some respects be more developed.

#### **IV. Can There Be Economic Reforms in Isolation of Other Reforms?**

The official Soviet view seems to be that economic reforms cannot be really successful unless they are accompanied, or even preceded, by measures intended to enhance significantly both industrial and political democracy. This implied willingness to diffuse and share power would appear to run very much against the practice of communist-dominated governments. Gorbachev's emphasis on the existence of a link between economic improvements and social and political reforms is therefore one of the most intriguing and paradoxical aspects of his *perestroika*. I have already indicated what a possible interpretation of this important paradox may be.

Gorbachev, according to this interpretation, intends to do what he says. Markets are to be given some of the economic disciplinary powers of the intermediate levels of the administration. This arrangement would give the centre more resources to play with and more time to concentrate on taking important decisions. The intended redistribution of economic power is thus away from intermediate levels, including ministries and the Gosplan, to words enterprises and the top centre. But once enterprises are given more powers, some of it can be diffused further down, to workers themselves. A significant power-sharing is, however, intended to be limited strictly to enterprises. Some wider political democratization, in particular a more open but still very much controlled mass media, may also be useful to the centre, as noted above, as a means of disciplining lower and intermediate levels of the party and state hierarchy more effectively and gaining wider support.

The new party leaders seem to be concerned by evidence that the post-Stalin policy of neither terror nor democracy has reduced the fears within the nomenklatura group and, consequently, started to turn it into a constellation of vested interests. Since massive terror is not an option, these vested interests can be more easily identified and more effectively confronted only through a dose of democracy, generating pressure from below and providing the power for the guns of the mass media to put pressure from above. The aim is to make the nomenklatura as a whole a more disciplined and more effective instrument of the top central powers. This democratization, however, is and must remain a measured affair. The nomenklatura, whether old or renewed, remains after all the primary constituency for the top leaders, their most important power base. It is in any case in the leaders' and their party's common interest not to give rise to expectations and demands of democratic reforms, the meeting of which is possible only in a competitive, multi-party political system. It may be safely assumed, I think, that both Gorbachev and his renewed nomenklatura, as well as most of the 20 million membership of the Soviet Communist Party will do their best to keep political reforms limited and the expectations in check, in order not having to face the dilemma of either refusing these demands, risking a major political crisis, or accepting them and risking a major loss of power.

Gorbachev appears to be a shrewd operator who understands the dangers of going to far. He is certainly not a Soviet Dubcek. At the same time, his insistence on the link between economic efficiency and political democratization is novel in the USSR and, if he persists to talk about it and acts on it, is potentially undermining the political system. This is the prospect that is electrifying for the Western observer and confusing for

the Soviet citizen. My interpretation of Gorbachev's novelty and his reforms assumes that he is a communist leader-reformer, who finds it necessary to shake and de-stabilize somewhat the old system, in order to preserve it. This means above all the preservation of the two features of the system: (i) the dominant role of the communist party and its cadres and (ii) the continuing cultural integration of Soviet nations based on Russian language and culture. So far I find the assumption realistic, that is, compatible with Gorbachev's critical analysis of the past and with his reform proposals for the future. To have a balanced view of Gorbachev and his *perestroika*, it must be noted that the above mentioned two principal features of the Soviet political system are never much emphasised, that they are practiced rather than openly discussed. This absence of discussion is itself a signal that the fundamentals are to remain unchanged.

Suppose, then, that the Soviet political system remains much the same as it has been, more enlightened and less repressive, but dictatorial all the same, continuing to deny most of the non-communist large majority any substantive political rights. The perplexing question is whether it is feasible to have a communist-dominated country which combines such a Soviet-type political system and a truly market-based economy. That is, whether it is feasible to have a communist equivalent of, say, South Korea until recently or Spain under General Franco. Given the intense interest of communist elites in preserving their power while at the same time improving economic performance, it would seem that such a combination is not only feasible, but should become the dominant social order to emerge in state socialist countries during their transition, over the next several decades, to more democratic forms. This view, correct or not, does not seem to be undermined by the recent evidence from the USSR that some limited democratization may be a necessary precondition for starting the process of marketization. However, the experience of Yugoslavia, Hungary and Poland suggests that marketization gives rise to anxieties and resistance among many social groups and, as a consequence, the centre may not be able to go far enough unless the policy is legitimized by clear evidence of majority support. That support may be difficult to generate and identify in the absence of democratic institutions. In their absence the many individuals who wish to be protected against the risks of a market economy form a powerful alliance with the members of the communist authorities who wish to preserve their power by continuing to offer such protection. A paternalistic protection develops taking the form of fiscal measures, price controls, management of the market structure, preferential allocation of credit, foreign exchange and key materials,

and so forth. A high incidence of such protection has obvious direct inefficiency implications. It also encourages the proposed enterprise-based appointment committees to continue the practice of hiring managers with good ministerial or party connections, rather than entrepreneurial talent, with further indirect inefficiency implications.

Paternalistic protection of enterprises is, nowadays, a world-wide phenomenon. But its extent seems to be related, among other factors, to the type of ownership of the enterprises involved in it, private ones receiving on the whole less protection than state-owned ones. The relationship itself is influenced by the prevailing climate of social ideas in general and the ideology of the ruling political party in particular. Socialist ideology and state ownership tend to breed strong expectations of and demands for paternalistic protection amongst workers, and strong motivations and justifications for exercising that protection amongst political decision-makers. As a consequence, a social contract of a particular type develops between the workers and the socialist state. The contract's long and entrenched presence in the USSR restricts the freedom of Soviet reformers to move the Soviet economy in the direction of a socialist equivalent of the Spanish or South Korean model. For this reason alone, such a socialist (competitive) market economy may well be a contradiction in terms and, therefore, not really feasible. The reform experiences in Eastern Europe so far provide ample evidence in support of that view. What may be expected realistically is that Gorbachev's reform, with its limited ideological de-socialization and some privatization, will begin to push the Soviet economy towards that socialist equivalent, but in a very gentle and gradual manner, possibly stopping far short of the target itself.

### **V. What Impact Will the Attempted Reform Have?**

Given the various risks and barriers to marketization of the Soviet economy, its transition to 'self-financing socialism' is likely to be a long process, taking perhaps many decades. As in Yugoslavia, Hungary and Poland, so also in the USSR state enterprises may become a little more cost-conscious, but not nearly enough for this improvement to have any significant impact on the qualities or quantities of their products. A major improvement would require a radical restructuring of the economy in terms of the production processes used and the labour skills employed. Such restructuring would in turn require a deep, market-aided surgical operation, a widespread closure of inefficient production lines, phasing in of many new products and processes, massive retraining and a far reaching redeployment of investment resources and the labour force. A

radical operation of this Thatcher-type category is nowadays advocated by many economists in Eastern Europe, but it seems to have been already ruled out by the authoritative Soviet reformers, who for reasons I discussed above tend to be cautious and evolutionary.

The changes which may realistically be expected to arrive in the course of the next several years will be above all the result of greater monetarization of the economy, in the form of greater price flexibility and enhanced role of financial planning at the expense of planning in physical or quantitative terms. There should also be a significant impact of some privatization of the economy and decentralization of decision-making, especially in the provision of services and in agriculture. About a third of all prices are expected to be allowed to move relatively freely to levels at which demands equal supplies. Market shortages of many of the consumer goods produced or imported should thus be reduced or eliminated. The shortages of intermediate and investment goods, now an immense problem, may also become somewhat less acute. Any improvement will be related to the extent to which the two major principles are implemented: (i) that government demands for goods are formulated in value terms, and not in terms of specific quantities, and (ii) that these money-denominated demands are relatively stable, not responding automatically to changes in prices. Both these principles are at the heart of the proposed reform, but go very much against the present practice. Their adoption, in Hungary and Poland, has been and continues to be strongly resisted, for reasons which also operate in the USSR.

Soviet reforms, however inadequate and poorly implemented, should nevertheless legitimize the criticisms of the traditional economic system, stimulate reform debates and promote reform-minded politicians to positions of power throughout Eastern Europe. At the moment there is still considerable ambiguity about the precise content of Soviet reforms and uncertainty about the political fate of Gorbachev himself. In Czechoslovakia the conservative Gustav Husak and his colleagues have nevertheless decided to re-open reform discussions. This was for them a highly uncomfortable decision to make, as it required a re-interpretation of the Dubczek reforms of 1968, the suppression of which gave them the present positions of power. The most liberal of the typically very cautious East European leaders, Janos Kadar of Hungary and Wojciech Jaruzelski of Poland, will feel less restrained. Their so far highly limited reform programme has now a good chance of becoming a model to be followed throughout the Comecon area. This is already happening, to some extent, in Bulgaria and Rumania. East Germany is the only country in Eastern Europe strongly resisting any thought of substantial economic decentralization and marke-

tization. But there is perhaps no need to reform an economy which is seen to be performing well, although the reasons for this success are probably German-specific rather than system-specific.

More difficult to handle for the communist leaders of Eastern Europe are possibly Gorbachev's political rather than economic ideas. His repeated calls for political democratization are unlikely to be misunderstood in the USSR, where they would be widely perceived to serve the top centre an instrumental purpose. However, these calls are inflating expectations and may even be destabilizing in the countries with some traditions of political democracy, such as Czechoslovakia and Poland, or those exposed daily to the mass media of their democratic neighbours, such as East Germany and Hungary. The evidence of growing popularity of Soviet mass media in Eastern Europe is apparently, and paradoxically, causing concern of the local governments. These concerns may well be shared by Soviet leaders, for whom any evidence of Gorbachev-inspired political instability in Eastern Europe (or the USSR for that matter) would be regarded as a serious warning that he is moving too fast and too far.

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