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PERESTROIKA, PHASE III:

CAN THE USSR LEARN FROM THE ONLY SUCCESSFUL REFORM?

Phillip J. Bryson

University of Pittsburgh Center for
Russian and East European Studies

Phillip J. Bryson is Professor of Managerial Economics at Brigham Young University in Provo, Utah. He is currently a Fulbright Fellow at the Research Center for Comparative Economics at Philipps-Universitat Marburg in Germany. With Manfred Melzer he recently published *The End of the East German Economy,* St. Martin's Press, 1991. He has published numerous papers on East Germany and the Soviet Union.

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I. Introduction

In Phase I of Mikhail Gorbachev's tenure as chief director of Soviet economic strategy, the General Secretary seemed content to continue an approach his predecessors had referred to as plan "perfecting" (*sovershenstvovanie)*. This approach which called merely for the development and implementation of modest improvements in the planning mechanism. It was the chosen alternative to economic reform, the approach which had been peremptorily rejected with the closing of the Kosygin reforms at the end of the 1960s.

This plan-perfecting strategy had not yielded any noteworthy improvements in economic performance for Gorbachev's predecessors, but when combined with some Andropovian austerity, it had seemed to offer promise. Moreover, plan polishing had been implemented with some apparent success in East Germany, and at that point was certainly more in harmony with the party's philosophical position than a program of economic reform. Some of the techniques that had seemed effective in the GDR appeared to be of interest to Gorbachev, and a number of the planning techniques and policy elements that became a part of Phase I's early doctrine of "acceleration" *(uskorenie)* and, for that matter, even of Phase II's economic reconstruction *(perestroika)* seem strongly reminiscent of East German innovations and practices.[1]

As it became apparent that the initial strategy would not yield an acceptable harvest of productivity growth, Gorbachev's rhetoric took on a revolutionary tone,[2] and he began to insist on the implementation of radical reform. He thus moved beyond the initial step of tinkering with economic planning, and his economic probing was accompanied by cultural (glasnost) and political *(demokratizatsiya)* programs that have already guaranteed their author immortality.

By 1987 perestroika seemed well launched, but from that point the Soviet Union entered a phase of ostensible consolidation with additional change coming primarily in the political realm. To some degree, the complexities of political change led to a deemphasis of economic processes. Even worse, the individual Soviet republics watched the pleasing developments of 1989 in East Europe and began to vent increasingly open and strong desires to obtain their own independence. The political turmoil and the nationalities question helped usher in a period of economic stagnation.

Of course, economic misery was not merely the result of neglect on the part of the reformers. It is widely argued that Gorbachev's programs broke down the institutions of balancing and of central supply provision, but did not replace them with market relationships. It is true that market relationships have not yet been established, but there is appeal in the argument that the planning apparatus has *not* really been broken. It still functions to some extent, although the reform effort has tended to confuse and complicate traditional production relationships. In any case, there was little energy or political will in this period of political turmoil to introduce new and vital initiatives. And from the initial reform legislation and organization, numerous measures had still not been incorporated or had not really been implemented.

The strong, directed action needed in the Soviet Union can be thought of as Phase III of perestroika. This paper will address a number of the essential measures still required to extract the Soviet economy from the deep economic crisis it had entered by the early 1990s. Unfortunately, it cannot be guaranteed that the necessary measures will be effected in time. It can only be hoped that this is the Soviet Union's darkest hour, and that a Phase III could bring new hope for perestroika.

The birth process of democracy in the Soviet Union may miscarry or be aborted if perestroika should fail. To this point, no substantial economic progress can be demonstrated for Soviet economic reform, and there seems to be rather distressing consensus both in and outside the Soviet Union that none can be expected for some time.[3] The thesis of this paper is that perestroika will have to receive new impetus and directions; the ongoing Soviet search for an economic plan to achieve marketization and privatization demonstrates that impetus and direction are still lacking. Without them, the economic process cannot be expected to shift to a new level, i.e., to enter the third phase of Gorbachev's economic leadership.

The next section (II) of the paper will review various core principles of Soviet reform, focussing on some of the reasons, all too well known to the expert, for the insufficiency of Perestroika's Phase II. Section III will discuss two important variants of reform in pre-Gorbachevian East Europe, *viz.,* the early Polish and the New Economic Mechanism of the Hungarian reform. These cases demonstrate, as would other examples, the difficulty (one might argue the impossibility) of partial reform under the constraints of traditional Marxist-Leninist socialism. Sections IV and V will address the only previous successful attempt to dismantle a centrally planned system, *viz.,* the West German postwar experience under Ludwig Erhard. Section IV will discuss differences in and section V will discuss similarities between the approach that was taken by the Federal Republic of Germany in the early postwar period and that of the Soviet Union today.

II. The Insufficiencies Of Perestroika

The common central theme of East European economic reform is that independence for the individual enterprise is vital. Such independence represents the attempt, through the creation of the appropriate accounting conditions and legal forms, to induce state-owned firms do to respond as firms in a market environment.[4] If designers succeed in implementing this procedure, producers will be motivated to pay more attention to consumer preferences, to the quality and assortments of their products, and to using resources and innovations efficiently. Properly designed institutions would both enable and induce enterprise management to function in every phase of their activity without ministerial "petty tutelage" *(melochnaya opeka).*

The necessary legal condition for genuine self-management is met by the provision in the Law on the State Enterprise[5] granting that the institution "the right, at its own initiative to make all decisions...not at variance with existing legislation." Anything not specifically forbidden is permissible! The sufficient condition is, of course, the actual enforcement of the law that extends the desired independence to production units. It is interesting, if not ominous, that an earlier section of the law appears to make enterprise independence, expressed by the power to plan its own activities and enter into contracts, subject to numerous constraints. In this process, the enterprise is "guided" in its independence "by control figures, state orders, long-term scientifically substantiated economic normatives and ceilings, as well as consumers' orders."[6]

One of the most basic challenges of perestroika is for the reformers to design laws and institutions in such a way as to break the control of the ministries and planning agencies over the activities and decision processes of individual production units. The phenomenon of central intervention was a natural part of the epoch attempt of Marxist-Leninist socialism to remove "exploitative" pricing prerogatives from the firm, placing the pricing function and the responsibility to assure the production of goods corresponding to the economy's needs in the hands of planning and ministerial bodies. Gorbachev wants to restore to the enterprise the functions both of production and price formation, but has not yet removed from the central and ministerial agencies the responsibility to assure the availability of outputs demanded. Hewett has made the point forcefully that this is a potential cause of failure for the entire reform movement.[7] If this responsibility is not removed from the ministries, they will quite naturally intervene in production activities with every available measure, and with the required intensity and frequency to assure that their responsibilities are met.

In his advocacy of the socialist market, Aganbegyan[8] retains the *caveat* that prices for key products (such as fuel, electricity, the most important raw materials, rolled steel machinery, and some consumer goods) will continue to be set centrally, so as to equip the government with some control over the rate of growth of prices. Nevertheless, price formation will be considerably less centralized and commodity sales will be by contract and "with freely set prices."

These measures could normally be viewed simply as a policy prerogative a government would be expected to retain. But in the Soviet case, when the planning apparatus holds open the option of price control to stave off inflation or to achieve other planning objectives, we must expect the worst. Since the reform effort cannot be expected to avoid powerful inflationary pressures in the process of decontrol, to give the bureaucracy advance party approval to intervene as inflationary dangers dictate is to expand substantially the likelihood of reform sabotage.

The Law of the State Enterprise preserves an activist role for the ministries, leaving them the right to issue norms and limits for the enterprise, to confirm state orders, to coordinate basic planning data, and to provide uniform technical policy. The ministry is authorized to give the enterprise assistance in technology matters, inter-industrial relations, and in foreign economic activities.[9]

A regulatory role to counter the "monopoly tendencies of individual enterprises...to overcome the overstating of unit cost and prices, stagnation in the technical development and artificial restrictions on the production and marketing of output enjoying consumer demand"[10] is also established. Although such powers bode ill for economic devolution, opening the door for extensive ministerial and agency intervention, the new legislation does make provision for enterprise appeal should the "higher-level agency" issue an act or regulation in violation of "legislative requirements." An act can be declared fully or partially invalid by the state court of arbitration if it violates the new legislation, entitling the enterprise to compensation for losses inflicted by the process.[11]

What seems most inimical to the independence of production units is the general attitude of planners and legislators toward the ministries. When one considers the prescribed role of the ministries and planning agencies, in spite of emphatic Gorbachevian strictures on "petty tutelage," there are numerous openings, even requirements, for central intervention in enterprise activities. Where the slightest opportunity exists, ministries quickly develop patterns of systematic intervention. The provisions of the new law were too often expressed in insufficiently concrete terms. According to one Soviet observer, more than half of the new legislation consists of "theoretical judgments, wishes, and indefinite prescriptions," and many of the norms that survived the passage of the reform laws "preserve elements of the obsolete economic mechanism and block radical changes in it."[12]

The planners will continue to supply planning norms even after the intended introduction of full *khozraschet*. They will thus continue to suggest or mandate capital charges, growth relationships between average wages and labor productivity, levies on the wages fund, the use of hard and foreign currency revenues from foreign markets, the uses of all enterprise earnings (divided among investments, factor payments, social outlays for worker benefits, etc.), the economizing of energy and materials in production, and much more. The ministries are to establish concrete normative magnitudes tailor-made to individual enterprises in their jurisdiction, establishing a stable framework for five-year periods.[13] Given their hierarchical mentality, the enterprise interpretation of ministerial "suggestions" will be that they are mandatory.[14]

A healthy menu of activities was also envisaged by the Law of the State Enterprise for GOSPLAN, although the preference of the legislators was clearly for perspective activities. The section of the legislation addressing the future role of the national planning agency begins with the observation that the planned direction of the economy is the most important achievement and advantage of socialism, and the main instrument for the realization of the economic policy of the party. Planning energies, however, must be shifted from annual to five- and fifteen-year planning periods, i.e., to the solution of strategic questions.

GOSPLAN's functions include the planning and implementation of activities affecting the economy's structure and proportions, the individual regions and branches, the directions of scientific-technical progress, and so on.[15] Planning agents interpret these general tasks as requiring intervention where independent enterprise action cannot be relied upon to achieve the party's social objectives.

The imperfection of centrally determined prices is responsible for many of the basic difficulties of planning. Under the pricing regime of central planning, scarce resources and commodities are not used economically by producers or consumers; arbitrarily low prices imply that a productive factor or commodity is abundant and may be used (or even squandered) in the place of one with an arbitrarily higher price. Nor can the productive performance of an enterprise be evaluated so long as it pays arbitrary prices for its inputs and receives an arbitrary price for its final product.

Two primary difficulties plague Soviet-type pricing: Stalinistic attitudes toward prices and Stalinistic central planning traditions. The prevailing attitude in the USSR has always been adverse to market price formation, and the conviction likewise prevails that low prices are "good" and high prices "bad." Accordingly, institutions have been designed to facilitate control of movements of prices. These institutions have made price adjustments difficult, unwieldy, and slow; they do not respond to changing economic conditions, preferences, or profit possibilities. Now that the desirability of greater flexibility has become more apparent, Soviet planning administration must live with the impossibility of keeping from 12 to 18 million prices responsive to changing economic conditions.

The Soviets expect this to change in the process of "radical and total reform,"[16] under which all types of prices will be properly adjusted to reflect costs (i.e., will be revised) and the processes of price determination will be decentralized (i.e., will be reformed). Of extreme significance is the general recognition by the reformers that perestroika cannot succeed without price restructuring.[17]

The price reform was scheduled to be in place in 1989 or 1990.[18] It had also been announced for the beginning of 1991 with the initiation of the 13th five-year plan.[19] The intent was to democratize the process of price formation, reducing reliance on centralized direction and broadening the domain of contractual and unrestricted prices.

But the section of the Law on the State Enterprise, "Basic Directions and Restructuring of the System of Price Formation under the Conditions of the New Economic Mechanism," failed to make a clear break with the past.[20] It spoke of unjustified centralization in price formation and of the need to incorporate "use characteristics,"[21] or demand considerations into price formation. Unfortunately, the "old thinking" was also betrayed. One suggested change, for example, was to overcome the tendency "to raise prices through the economic competitiveness and competition of the enterprises."[22] When "reviewing the level of prices" is mentioned, one senses the expectation that the pricing agency will always exist and always be handling whole sets of prices that otherwise remain untouched and unchanged for years on end. Even if such adjustments coincided with market realities, any dynamics would render them obsolete very quickly, long before the next central readjustment.[23]

The new legislation also contains a stricture that price changes "may in no manner cause a deterioration in the level of living of the workers; on the contrary, for certain categories of workers they must lead to an enhancement of that level and to a complete realization of social justice."[24] Although price formation through enterprise self-management and contracting should reduce the role of the central pricing apparatus, the new legislation calls specifically for an *increased* role for state pricing policy and its responsible executor, the State Committee for Prices *(Goskomtsen).* The widely heralded promise that contract pricing will become increasingly important, offers little consolation, for the section of the Law of the Enterprise granting (strictly proscribed) pricing prerogatives to the socialist firm retains very large caveats. Article 17.7 provides for the guidance of enterprises by centrally established prices and by prices confirmed by ministries and departments.[25] Not surprisingly, price-formation agencies will determine the procedure for establishing contract prices and monitor their application.

An excellent opportunity to undertake a de facto decentralization in pricing appeared in March, 1988, when the draft of a Law on Cooperatives was published. This new legislation put cooperatives on the same legal footing as state enterprises regarding self-management, self-finance, and self-planning. It does not restrict the new cooperatives to any particular activities, and they are not subject to central planning. Larger units may enter directly into export arrangements, and are to have discretionary use of foreign currency earnings.

Approximately fifty thousand cooperatives came into being in the first year after passage of the law (by 1991 the number was four or five times as great), but they have, unfortunately, already encountered substantial opposition. Consider, for example, the hundreds of restaurants that were established in that period. Some Soviets have been willing to pay considerably higher prices than those of the state enterprises, correctly anticipating that the quality of the food and the service would be superior in those outlets. But many Soviet citizens have been firmly opposed to the dramatically higher incomes this generates for the new suppliers.[26] Soviet citizens are apparently not yet prepared to tolerate the kinds of income differentials that will permit an unleashing of the productive activity the cooperatives were designed to evoke.

As a result, the Soviet Council of Ministers[27] promptly decreed their displeasure with the new producers. It was alleged that the cooperative response to strong demands had not been to increase supply in the spirit of service for the public, but simply to charge higher prices. The Council deprecated the laxness of the government agencies which had permitted this to occur, but promised that central agencies would henceforth be prepared to intervene against such "abuses." An alternative policy more in harmony with the reform would be to facilitate the entrance of more cooperative suppliers in these popular markets. Many producers would likely be happy to share the spoils, and their entry into the market would augment supplies and encourage falling prices.

The new cooperatives, especially the agricultural ones, are encountering another form of opposition more odious to Gorbachev. In spite of the passage of the Leasing and Cooperative laws, these new arrangements are not being established basically because they are encountering every possible bureaucratic obstacle. The would-be leasers say that the local organs who direct the state and cooperative farms are not in agreement with the program directed at the farmers and laborers. Many of them, Gorbachev complains, would prefer to manage things according to the old methods, and they hinder the implementation of economic accountability in agriculture. Gorbachev correctly believes that land must be given to individuals to manage, "so that they are truly in charge of their own land, so they will be properly motivated to increase agricultural production."[28] But any property arrangements short of private property, no matter how innovative, will not produce the desired effects in the Soviet Union. This is because farmers realize that so long as the land is not their own and that prevailing property rights remain the prerogative of the party, the rules can be changed and the incentive characteristics aspired to by any property rights arrangement short of ownership are lost.[29]

The cooperative movement taught another important lesson. Soviet citizens have been trained for nearly seventy years to believe that they had an inalienable "right" to stable prices, learning very early that inflation is a phenomenon that can occur only in capitalism. Their ongoing concern about price stability is a great barrier to progress for perestroika, since Soviet directors are convinced that they cannot afford to cease their heavy subsidization of basic commodities and permit prices to rise. Moreover, it has recently been revealed that the government's budget deficit is considerably larger than had been previously admitted. That deficit arose from the extensive subsidies, large and often unwise government expenditures, and wage and bonus payments that supplied consumers with rubles greatly in excess of the supply of goods being produced. Excess cash and its concomitant inflationary pressure are much larger than had been thought. Now shortages are so rampant through the economy that to cease subsidization or to decontrol prices could mean a price explosion.

As a result of this fear, Abalkin confirmed early in 1989 that the price reform, scheduled for implementation by 1990 would be postponed.[30] That was disappointing because it implied that, at least for the time being, the reforms could not really be implemented. Without scarcity prices, there cannot be real reform; without control over the price level, support for the reforms cannot be sustained. Since about that time, Gorbachev has seemed to be in a zero-win game.

A final problem from a sampling of the many available, is the widely discussed "human factor." From the perspective of Gorbachev,[31] this is one of the main problems perestroika must address. The reformers observe that once people have been liberated from the constraining institutions that had undermined incentives in the central planning environment, they must take initiative and attack their problems. Perestroika has given managers and agents in the state economic organs the opportunity to act, e.g., to form new cooperatives or pursue self-employment. Says Aganbegyan,[32] they must end their dependence, cease simply to wait to see what the center will do and what the center will demand from them, and exercise their rights. The power is "not simply given but must be taken."

Abalkin and Loginow share the view that considerable room for productivity growth still exists, which *inter alia* indicates that the human factor problem remains far from resolved. These "reserves" can be tapped, according to this view, through the reduction of absenteeism, the achievement of order and discipline, improvement in the establishment of norms, the application of progressive forms of scientific labor organization, and through the process of innovation. They estimate that through the elimination of absenteeism alone, industry could achieve a labor productivity growth of from 15 to 20 percent. Furthermore, large labor losses arise through insufficient infrastructure and the poor quality of products available.[33]

But the human factor problem is much larger than these considerations imply, and it is also larger than economists originally supposed. When perestroika was yet in its infancy, economists were inclined to the belief that socialist training in shirking and the party's alienation of the working class could be overcome simply by getting the incentives right. It is no less true today that incentive incompatibilities must be removed from Soviet economic institutions, but today economists are probably less sanguine about how readily seventy years of dependence training, worker hostility, and cynicism can be overcome. Similar observations are appropriate for managerial personnel. Entrepreneurial spirit must be permitted to exist, but a more favorable environment will not immediately compensate for the system's near-century long failure to develop a personality willing to take innovative initiative, to bear risk, and so on.

All these considerations seem to indicate that the reforms did not go far enough.[34] Not only has the reform legislation been of a lesser order of magnitude than will prove necessary; as political initiatives became the chief focus of the reform and the inviability of the Soviet Union became more apparent, economic progress bogged down. We are left to hope not only that the interested opposition will be unable to block reform implementation, but also that new initiatives will cause perestroika to become reanimated. Originally, Gorbachev appeared willing to extend the reform effort as far as necessary. Certainly his rhetorical support of perestroika was impressive, and the energy and vision of the reformers surpassed anything we had previously experienced from the Soviet Union. But over time Gorbachev has begun to reveal the limits of his flexibility. He changed many early positions (moving from phase I to phase II) as the need arose, but he appears unable to overcome his fear of (or to forge a consensus for) price increases, genuine private property arrangements, and the establishment of a more viable economic community of independent states from the Republics which now comprise the Soviet Union, and so on.

A particular difficulty for perestroika has been the huge Soviet budget deficits, which by the beginning of the 1990s had gotten out of hand. When the seriousness of the attendant inflationary pressure became apparent, Gorbachev recognized that marketization under such conditions could only set off a price explosion. In his first speech before the new Soviet parliament he attacked the idea of a complete adoption of market mechanisms to overcome the accumulation of difficulties, and expressed the belief that this would immediately undermine the whole social situation and destroy "all processes in the country."[35] But in the same speech the new Soviet President indicated that a "decisive direction" of the reforms would have to be the development of a "pulsating socialist market."[36]

The problem is, as always, one of getting from here to there. At the end of 1990, the whole union was agonizing over what might be an effective plan for the establishment of a market system. Gorbachev faced two alternative proposals: the bold, if not highly original Shatalin-Yevlinskii plan supported by Boris Yeltsin, and the cautious Abalkin plan.[38] The Shatalin approach, strongly influenced by the Balcerowicz plan implemented in Poland,[38] would have taken the plunge to achieve the desired objective in 500 days. The Polish "model" represents an extremely important economic experiment, since it holds out the possibility of making that country only the second one ever to overcome a central-planning history. The Polish attempt to achieve marketization was modelled after the "economic miracle" constructed by Ludwig Erhard, whose quick and thorough elimination of central controls in postwar West Germany will be discussed with more detail below. Balcerowicz carefully studied the West German economic recovery before receiving the opportunity to implement his "shock therapy" in Poland. The Soviets have watched Poland's attempt to transform its economic system with interest, and Shatalin was certainly convinced that this was an effective path to take. After all, in but a few weeks the Polish had watched a runaway inflation disappear in short order. The ubiquitous socialist queuing also vanished, since almost overnight the normally empty shops were replete with goods. Gorbachev, however, who by the 1990s enjoyed precious little popular support within the Soviet Union, recognized that the public must have considerable confidence in its government to endure the sacrifices to which the Polish people have been willing to submit themselves under the Balcerowicz plan.[39] He remained opposed to anything that might disrupt the already tense social situation in the country.

Neither of the two alternative Soviet marketization plans was well-developed conceptually; Gorbachev was inclined to support the more gradualist approach, but he commissioned Yeremenko and Aganbegyan to work out a compromise, which within weeks seemed about as forgotten as the "defeated" Shatalin plan. Nevertheless, the next step came soon thereafter and showed considerable courage; it was the currency reform of the last week of January, 1991, and will require our attention again below. Legislation pertaining to economic reform continues to be prepared and produced in Moscow. Unfortunately, it remains true in the Soviet Union that legislation is only significant when it is enforced. Traditionally, the party has had to stand behind any laws that were to have teeth, and if the party ignored laws, it was as though they simply did not exist. Moreover, the law might permit enterprise freedom of action, for example, and the enterprise might even have cash to launch some productive venture. But if the enterprise could in fact find no productive inputs, no available capital equipment, and no contract partners, the law could not contribute substantially to the achievement of economic decentralization in the intended manner.

In spite of the delays, apparent indecisiveness and lack of progress since perestroika's advent in the mid-1980s, Gorbachev and his supporters remained convinced that the only hope for the development of the economy was the consistent pursuit of economic reform. The General Secretary admitted that the reform is very complicated, and that its successful implementation will require some complexly interrelated steps directed to change "the methods of planning, of financial levers, of prices, of taxes, wages, and all of the other parts of the economic mechanism." Much still had to be accomplished before the inauguration of the 13th Five-Year-Plan, and the reform would simply not be possible "without a radical renewal of socialist property relations." The only condition that must remain on these relations, Gorbachev asserted, was "that the exploitation and alienation of the workers from the means of production must not be permitted."[40]

III. Combining Market And Plan

Since 1987 it has become increasingly apparent, as has been demonstrated above, that perestroika is scarcely as radical as its promoters' rhetoric. Both the legislation, taken rather faithfully from Gorbachev's widely publicized conceptions, and the implementation of reform measures leave a substantial cleft between the basic values pursued (e.g., financial independence and accountability of enterprises, more viable prices, worker participation in management, etc.) and the actual achievements. Perhaps the Soviet Union's performance can be thought of as the intermediate case between Phase I's evolutionary approach (planning amelioration) and the truly radical case of decontrol, decentralization, and marketization of Phase III. The actual goal of Soviet planning, whether or not that is apparent from the outcomes thus far achieved or from the guiding legislation discussed above, is to achieve a socialist market. This market's functioning will differ, at first, in certain critical respects from that of a contemporary, market-based economy, but will over time likely move more toward the Western model as it becomes apparent that many of the institutions common to "capitalism" have developed historically for purposes other than just the exploitation of the workers. Initially, at least, the socialist market of Gorbachev's conception would function with the guiding assistance of a sort of indicative plan.

Bogomolov has expressed the conviction of the Gorbachev reformists that the use of "commodity-monetary instruments" (read "market transactions") together with the norms and rules established by the state, cause planning to become more, rather than less, effective.[41] It will be necessary for the Soviets, according to this view, to replace the mandatory state plan with a guiding plan that will provide neither commands nor targets to the enterprise, but only reference points. Bogomolov felt that such a system had "proven itself in Hungary and China."[42] Since such planning can unleash the initiative and creativity of agents and institutions, it can guide and strengthen the processes of economic development.

Before the peaceful revolutions of 1989, the most popular East European model for Western economists was the Hungarian case, since that country tried early and long to dismantle central planning institutions. The thesis of this paper is that in the Brezhnevian environment that approach was a rather unmitigated failure. It provided evidence that a marriage between central planning and market mechanisms cannot guarantee successful economic reform. If Hungary's march into the 1990s is to witness a new thrust for systemic reform that can ultimately succeed, then that is because the intermediate reform model embodied in the 1968 "New Economic Mechanism" and currently being attempted by the Soviet Union, is being cast off by the Hungarians and other East Europeans as they move toward radical decontrol, decentralization, and a genuine transformation of their systems.[43]

It is the objective of this section to consider some of the reasons why the intermediate approach to decontrol (as embodied in the reforms of the 1960s) has to this point never succeeded in eliminating the inefficiencies and irrationalities of central planning. A brief review of a few of the attempts to join planning with market elements to attain a "third way" between socialism and capitalism is therefore recommended. No attempt will be made to consider the Chinese case in detail, since that could stretch the credibility of the paper.[44] It would seem foolhardy to claim, however, that China has already successfully overcome the post-1948 planning tradition, despite the introduction of reform measures, special free economic zones, and some other interesting experiments.

Current developments in China and Hungary suggest that central planning has not proven to be a suitable partner for market institutions. Nor did it fare well in labor-managed Yugoslavia. It may still be too early to argue, of course, that successful devolution is best pursued by a direct leap from Stalinist centralism to market mechanisms. The path between those two conditions may optimally take twenty years, and as long as one remains on that path the economy will function (to be euphemistic) suboptimally and struggle through hazardous times. If the economy is ever to function well again, it will only be after the goal of sufficient decentralization[45] has been achieved. The present author has begun strongly to doubt, however, that the gradualist approach can develop sufficient momentum to break the human and institutional obstructions to either the process or the outcomes of marketization. But let us consider here some evidence for the more modest proposition that the addition of market elements to a central planning system cannot result in successful reform.

The 1950s Polish Case

Poland, being not only a nation of creative and liberty-loving people, but also enjoying a large endowment of excellent economists, have been interested in economic reform since before the death of Stalin. A brief look at the Polish case in the 1950s is instructive if for no other reason than that what we read about it sounds so much like what we have continued to read about reform experiments since.[46]

In discussions about reform during that period, criticism of the prevailing system of planning and management (so well known to the student of virtually any East European economy), as well as the arbitrariness and excessive centralization of economic decision-making, were made forcefully by both theorists and practitioners. Proposals almost universally called for economic decentralization, by which was meant the extension of enterprise autonomy and greater scope for market forces,[47] which is also an effective and succinct way to describe perestroika. On April 9, 1956, a joint resolution of the Central Committee of the Polish United Workers' Party and the Council of Ministers extended the powers of directors of industrial enterprises. In many factories newly-organized workers' councils sought expanded rights.

The Polish economist Michael Kalecki, was convinced that a synthesis of workers' councils and central planning was desirable. Yet Kalecki warned against the illusion that such a system would be durable, free of contradictions, or easy to manage. By the end of 1957 there were 5,600 workers' councils to take up some longer-term issues (such as the introduction of new ways of organizing production, introducing departmental accounting systems, etc.), and also to address more practical matters (such as combating absenteeism and the decline in work discipline). But the basic problems with the Polish economy lay elsewhere. First, the councils had to operate without vitally needed reforms in the system of economic management. Also there was no radical reform of prices which would enable autonomous enterprises to perform according to more rational economic calculations. The system of planning failed to adopt wider use of parametric (price-type) indicators in place of administrative directives. Enterprises continued to be subordinated to central boards, subsequently industrial associations, and economic ministries, so there was little room for enterprise autonomy. As Oskar Lange had warned earlier, the workers' councils were in fact powerless.[48]

The incredulous Poles had then to discover what has, in Gorbachev's day, become the conventional wisdom. Poor performance was not so much the result of the way enterprises were managed; rather, it was a product of extreme bureaucratization and centralization. Once created, the apparatus tended to expand spontaneously. Many reformists of that time thought they were observing errors in economic policy, not the characteristics of the economic organization. Kalecki started to perceive the error only in the 1960s.[49]

The basic thrusts of the reform (the attempt to achieve enterprise interdependence and democratization of the economy through the broad participation of workers, workers' councils, and local authorities) both failed. In practice enterprises enjoyed little autonomy and were neither able nor willing to operate according to the principles of rational economic calculation. Restrictions on the activities of workers' councils likewise weakened the reform. Ultimately, and central planning was preserved. It would take another three and a half decades for Poland to begin to experience positive economic change of any real significance. Yet, as discussed earlier, it was not the result of economic reform, but of economic transformation a la Balcerowicz.

The Hungarian New Economic Mechanism

After some tentative reform measures beginning in 1956-57, Hungary's more serious New Economic Mechanism (NEM) was introduced in 1968 to replace plan directives with market relations among firms. It was intended that the scope of central price determination be limited, and that the domestic prices of exports and imports be linked to world market prices. Investment decisions were, in large part, to be decentralized.[50] As a result of the external shocks of the 1970s and the declining terms of trade confronting Hungary after 1973, the center made reduced use of NEM's market mechanisms.

After steps had been taken to recentralize the economy between 1972 and 1976, reform measures were again introduced in 1980 and 1981. The intent was to reestablish momentum for the New Economic Mechanism.

After Gorbachev came to power and the Hungarians became convinced that Hungary had a free hand in the direction of its economy, far more sweeping measures in both the economic and political realms were introduced. But the objective here is not to consider the Hungarian reform process after the removal of the constraints of the Brezhnev era. Of interest is the NEM approach, which provides supportive evidence for the proposition that combining market mechanisms with substantial central planning residuals cannot secure the efficiency and incentive properties of market-oriented systems.

To begin with, we may observe that the NEM did not fully address the "human factor" problem of socialism. Not until 1985 did new regulation introduce the possibility for firm employees, directly or indirectly, to elect top managers in state-owned firms. Administrative and political authority retained substantial influence regarding the pre-selection of the candidates and veto powers for the election.[51] The democratization process, which can be seen as part of the effort to regain the commitment of workers and thereby to increase labor productivity, was not possible before Gorbachev but moved forward rapidly thereafter.

NEM notwithstanding, one of the key problems of Hungarian (as well as of other variants of) central planning, remains the "soft budget constraint."[52] Through all the years of the Hungarian intermediate reform, granting or denying credit was hardly correlated with the profitability or credit worthiness of an enterprise. The credit system continued too frequently to prevent firms from failing. Actually, none of the measures attempted in the NEM, including those taken after 1979 in the second round of reform, achieved real success, although Belassa considered some of the later measures "important steps" towards improved efficiency. He predicted further steps would be necessary, perhaps over a period of time, in order to minimize the economic disruptions that necessarily follow abrupt changes."[53] By mid 1985, he felt the pricing improvements, the "linchpin" of the 1980-1981 reforms, would have to continue, although a good start had been made by introducing "competitive" prices in numerous industries.[54]

The second reform round also attempted to address the problem of investment. In accord with the attempt to overcome the "soft budget constraint," the state was determined to provide investment funds only when the profitability of the enterprise was disadvantaged by centrally-imposed deviations from world-market prices and when the choice among investment applicants would be made on the basis of "profitability at undistorted prices." It would take the form of a credit to be repaid in 10 years.[55]

An important innovation was the legalization of part of the Hungarian second economy, which Kornai defines as the sum of formal and informal private sector activity.[56] The Hungarian "good life" was achieved not because economic performance improved, but basically because so many people were working devastatingly long days at two jobs. According to Kornai, many were working themselves to the point of "psychological and physical exhaustion,"[57] which represented a poorly disguised cost of socialism.

All in all, right up to 1989 there remained a distressingly broad scope for bureaucratic intervention into the Hungarian economy. Kornai expressed a sentiment that is most likely shared by most observers of planning systems attempting to utilize markets, i.e., that there are certain critical values which pertain to the frequency and intensity of bureaucratic intervention into market processes which cannot be ignored without consequence. Once these critical values are exceeded, the market is "emasculated and dominated by bureaucratic regulation."[58] When this happens, as it did in the Hungarian state-owned sector, the market will continue to have some coordinating effect, but that effect will be weak. Worse yet, this development not only prohibits the harmonious coexistence of plan and market, or the functioning of a "regulated market," but assures the continuation of dual dependence for the firm, or put another way, the domination of the bureaucracy.

Before the recent period, in which the attempt has been made to extract completely the planning processes from the economy, Kornai expressed his uncertainty as to whether contemporary Hungary had basically reached the ultimate limits of reform,[59] and could counsel only waiting and watching. Since Gorbachev made irrevocable his cancellation of the Brezhnev doctrine and the liberation of East Europe, Hungary and the other relevant economies have rather uniformly demonstrated their conviction that trying to reform a central planning system is pointless. It must be replaced by a market system in its totality.

IV. The West German Case: Similarities With the Soviet Union

Consider now the single, historically-completed case of successful retreat from central planning: that of the Federal Republic of Germany. There are, of course, differences between nascent West Germany and the central planning systems of pre-1989 East and Central Europe. But what experts heretofore have failed to observe are the number of significant and striking similarities.[60] In order to establish this point, let us address first these similarities.

Early in the postwar period, a classic paper by Walter Eucken[61] detailed for an English-speaking audience how closely the Nazi German economy corresponded to the *genre* of the centrally administered economy *(Zentralverwaltungswirtschaft)*. Investigation of centrally managed economies causes one to marvel at the universality and persistence of the phenomena of irrationality and inefficiency resulting from the subservience of economics to politics in social systems that exercise power in the interests of its holders. Nazi Germany's central planning system began to emerge as the result of the rigorous implementation of full employment policies, and later from the militarization of society. But Germany pioneered techniques that have become common to central planning, and the economic phenomena experienced in wartime and postwar Germany were remarkably like those found in the Soviet Union, China, and East Europe.

Pricing problems

No one has yet discovered how a national economy can be made to function effectively in the absence of a market pricing system. During those relatively brief historical periods in which it has appeared to be possible to do so, later revelations of real economic conditions have disabused us of thiis illusion. Centrally-set prices result in distortions and inflexibility that preclude competitive performance, especially in the international economic realm. Yet centrally-set prices are a must, as Eucken pointed out, for the central planning administration, which cannot leave the development of the economy's structural direction to market pricing processes. It must, instead, "reserve the direction for itself, which was what happened in Germany."[62] In the light of planning experience from Eucken's day to the present, his insistence that one cannot have both centralized price management and decentralized decision making[63] seems less an ideological statement, and more an expression of simple economic fact.

The Soviet Union's current inability to decontrol prices stems from the presence of ubiquitous shortages and the fear of intolerable inflation. Precisely those concerns argued against decontrol in Eucken's day.[64] Naturally, those fears are not without substance, but there is an answer to the problem: it is the currency reform that represents an important part of perestroika's Phase III. Currency reform was widely discussed in the Soviet Union, but was rejected, probably because of the fear that the introduction of new currency would cause the independence-minded republics to counter by introducing their own currencies. The solution was perceived by perestroika's designers to be the (partial?) currency reform of January 1991.

The reform left the three, five, and ten ruble notes as valid currency, but replaced the old 50 and 100 ruble notes with new ones. Currency holders could trade old for new notes to an amount not exceeding 1,000 rubles. This arbitrarily removed from circulation large amounts of domestic currency with tremendous inflationary potential, and also eliminated ruble holdings outside the USSR. One immediate effect was to enrage citizens of limited means — who lost a large share of their savings, most of which had been accumulated because of the unavailability of purchasable goods in retail outlets. This move required courage from Gorbachev. Now, it remains to be seen whether a sufficient amount of excess purchasing power will be eliminated so as to make price decontrol possible.

The same solution was unavoidable in Erhard's launching of the West German "economic reform." The currency reform of 1948 was essential to eliminate the vast excess supply of money, defusing the potentially explosive inflationary forces in the economy. It was essential to permit the establishment of scarcity or efficiency prices, and to open the way for the convertibility of the currency so that the economy could claim the benefits of rather unconstrained international activity. All of these effects and their benefits must be achieved if perestroika is ultimately to succeed, and it will take courage to stick with the policies of decentralization, as the German case demonstrated.[65]

The imposition of a currency reform is accompanied by much social trauma. It is chemotherapy for a macro economy basically in a state of morbidity. Individuals are willing to tolerate the elimination of much of their money stocks only if they are convinced that such action is necessary to avert economic calamity. It is still too early to tell whether the Soviet currency reform of 1991 represents a first element of Phase III for perestroika.

Industrial Concentration

References to economies of scale and other benefits are often made to justify industrial concentration, a rather general characteristic of central planning regimes. Today, just as in the time of Eucken, it is "simpler for the central authorities to negotiate with a few large units than with many small ones."[66] I have heard almost the exact words from socialist economists referring to the centrally-planned economy.

In the case of Nazi Germany, the effects of industrial concentration proved very durable. Efforts were made in the postwar period to reduce accumulations of economic power; these were not totally successful and many were later rolled back. An attempt was also made to show that private power centers (banks, industrial associations, corporate supervisory boards, etc.) in the postwar, liberal economy became the practical substitute for centralized planning.[67] The problem did not prove insuperable for the Federal Republic; extensive participation in international markets helped to compensate for the insufficient competitive forces of the domestic economy, and this was combined fortuitously with the provision of social policy benefits to the appropriate social strata and co-determination *(Mitbestimmung)* for labor. For the Soviet Union, however, it is not clear what techniques of policy might most effectively curb the potential abuses of decentralized, but very concentrated industries.

The Objective of Constructing a Social Economy

Both of the decentralizing economies under investigation had important social objectives. Erhard hoped to gain social acquiescence for the demanding tasks of reconstruction by dedicating the "economic miracle" to liberality of social policy, although the central thrust was admittedly toward the creation of a larger social pie rather than a continual redivision of the dimensions of the slices accruing to social groups. Nevertheless, as Loesch has pointed out, Erhard transformed an administrative economy into a *social* market economy.[68]

A most significant difficulty for the Soviet Union in Phase III will doubtless be that the more apparent the departure from central planning becomes, the more difficult it will be to claim that the Soviet Union remains, in any sense, a socialist country. Had Erhard been willing to make the claim that he was determined to use the market mechanism, but only to construct a socialist economy with room for worker co-determination, large production units, and a plethora of social programs, we might have a different perception of the Federal Republic today. If Gorbachev retains as much emphasis on social welfare as the Federal Republic, that might satisfy the ideological demands of socialist reconstruction.

Shortage

Shortages and queues are the substance of daily reports from the Soviet Union. Postan reminds us that in postwar Germany a shortage of goods had been accumulating for years. To some extent, of course, this was the result of war destruction and the large and urgent need for reconstruction, but shortages were also a result of the planning system. Moreover, the shortages were combined with a plethora of money. Everyone had more than could be spent on rationed commodities and used for rent and fuel. Why, then, should one incur the personal costs of labor when the income earned could not be exchanged for food, household goods, or anything else desirable. So people avoided work and exchange, hoarding their labor power and their personal or small business inventories of commodities and supplies. Shortages were combined, in other words, with immense reserves of unemployed resources.[69]

In spite of the general shortages of the postwar German economy, the currency reform was possible because inventories were available. Once the populace had received a small number of Deutsche Mark[70] and additional funds could only be earned through sales, the shops in Germany were suddenly full. People had simply been unwilling to supply commodities for money with meager purchasing power. In the Soviet Union there are less abundant inventories available, but there are nevertheless consumer hoards of many items, and enterprise hoards of inputs that are sometimes substantially larger than counterpart capitalist firms' inventories. There are also abundant reserves of hitherto untapped labor power that can be used very quickly to expand production in Phases III of perestroika.

Worker Self-Management and Self-Determination

System managers under both Erhard and Gorbachev received a mandate to pursue labor tranquility and participation by offering workers a share in the production unit's decision-making processes. Postwar Germany was unique among Western countries in attempting to enhance the role of labor in the government of both national and private industry. The industrial code of 1946 stipulated that boards of directors *(Aufsichtsrathe)* were to contain workers' representatives. This first installment of German industrial democracy fell far short of its earlier promise, failing to raise greatly the workers' share in the direction of factories or shops.[71] Nevertheless, codetermination ultimately did contribute to worker satisfaction, and it remains on the Federal Republic's list of positive accomplishments of the economic miracle. It is still too early to say whether the approach of perestroika, i.e., the election of enterprise managers by labor collectives[72] is of as little worth in the promotion of the reform effort as casual evidence thus far seems to indicate. It is likely that as the conditions for labor self-management become more favorable, the new institutions may yet prove effective.

The Difficulties of Dismantling Central Control

From the point when a centrally planned economy (CPE) makes the decision to readopt the market mechanism to the point where the economy has actually acquired a set of market prices and achieved currency convertibility, an extended and rather rigorous transition period must be traversed. In the case of the Federal Republic the period lasted ten years. Decentralization and decontrol have been a rather wrenching experience in the Soviet Union. The reluctance of the leadership of the Soviet Union to move quickly and resolutely toward far-reaching decentralization is reminiscent of the occupying Allied Forces in Germany in 1945 who felt they had no choice but to continue the administration of Hitler's war economy largely as it had been. Stolper *et. al.* felt that had they tried to abolish the system "at one stroke, the chaos would have been even worse."[73] In the three subsequent years attempts to cope with ubiquitous shortages by strict official regulation proved increasingly hopeless.[74]

The administrative director of the United Economic Region at the time was Ludwig Erhard, who proposed that only the most critically needed raw materials and foodstuffs (e.g., bread, milk, fats, cereals, coal, electric power, iron, and steel) continue to be rationed at fixed prices.[75] Production then proceeded to increase at a speed which no one had foreseen. In the last six months of 1948 industrial production increased by an incredible 50 percent; the following year it did so again by well over 25 percent.

Wallich likewise gives the Federal Republic credit for overcoming a "substantial amount of government intervention" that remained in the economy at the time Erhard began to function as Economic Minister.[76] Naturally, as in any economic situation, many circumstances and events could not be controlled by the West German policy managers. To some extent, they were the benefactors of good fortune. They were favored by Marshall Plan assistance, enjoyed a commercial boom generated by the

Korean War, and profited from the powerful economic stimulus of the European Economic Community; all of which contributed to the *Wirtschaftswunder.* Still, good economic management was also important. The ingrained German dread of inflation motivated strict anti-inflationary policies, and a sound currency permitted the rapid dismantling of price ceilings, rationing, and materials controls. However, even with all these factors, experts do not doubt that decentralization was the key to Erhard's success.

West German decontrol went further and faster than most people would have believed feasible, but the Soviets can take heart in the important fact that successful decontrol need be neither perfect nor complete. In the German case, it was certainly not complete. Basic foods and industrial materials such as coal and steel remained under control for a long time after the currency reform and the decontrol of the lion's share of industrial consumer goods.[77] German agriculture was given strong protection, and was also shielded against domestic price fluctuations. Although on balance freedom was the dominant characteristic, the policy combined freedom with controls.

The Second Economy

The combination of excess cash, hoards of commodities, excess government regulation and taxation (in whatever form), will just about guarantee the presence of an "underground," "shadow," or "second economy." Indeed, in the pre-Gorbachevian (Brezhnevian) world the only interesting thing about Soviet economics was that which was illegal, ignored, or unwillingly tolerated.[78]

The same distorting influences that cause Soviet "corruption" and black marketeering to assume such large proportions were also at work in the German case. In the course of that country's central planning experience, even the most loyal and patient manager discovered that production could not be maintained simply by relying on the ration office.

Many essential inputs were obtainable by official permit only after agonizing delays, but they could be procured much more quickly on the black market or through barter arrangements. Naturally, personal contacts, the second economy, and bartering assumed ever greater importance. In an officially managed economy, these developments meant a drain on existing resources and a decline in the volume of official production. The second economy of Soviet socialism, which works essentially the same way as it had done in Germany, became so powerful under Brezhnev that it helped undermine the formal Soviet system. Wallich also sees the second economy as "the ultimate bankruptcy" of the command economy.[79]

V. The West German Case: Differences

Although many of the differences between the economic situation prevailing in the Soviet Union today and those pertaining to Germany in the 1940s are not really substantive, a number certainly are. Such differences generally represent problems for the Soviet Union that were not as confining or severe in the German experience, and solutions will require patience and creative policies on the part of the Soviet Union. Overcoming some of those differences will, in fact, require some substantive additional changes in the restructuring endeavors of the Soviet leadership. A combination of currency reform, freeing prices, pursuing currency convertibility, and other such measures will be perestroika's Phase III. One could only wish that these measures were assured and that they could guarantee the success of Soviet restructuring. But let us here consider some of the significant differences between West German decentralization and the Soviet case.

Property Ownership and Omnipresent Government

For many socialists, *the* central characteristic of socialist economics is the public ownership of the means of production. Although Gorbachev has demonstrated a willingness to engage in some experimentation, traditional socialist property relations have hardly been discarded. In contrast to the Soviet case, German central planning was *not* based on public ownership. Eucken argued that property relations are not really *the* significant issue in central planning. The combination of central administration and direction with collective property ownership is not necessary. In Germany the means of production on farms and in factories had remained predominantly in private ownership, but the owners could only dispose of their property to a limited extent. According to Eucken, there was "widespread requisitioning of industrial stocks," which were released only for the particular purposes of the central plan."[80] To the extent that public ownership stands in the way of effective incentive arrangements, it should be subject to appropriate alteration. The Soviet Union has already begun to address this problem in Phase II and it is probably not the strongest constraining factor.

The more difficult reform obstacle is that of the omnipresent government, which was as much a part of the German central-planning landscape as it has been for the Soviets. Stolper *et. al.* express the situation prevailing after the defeat of national socialism very well; they describe it as an economic system in which the government was "omnipresent and paramount."[81] Even today, many socialists feel that public ownership makes enterprise more willing to countenance change directed by the political authorities. In highly centralized systems managers quickly learn that their rewards are achieved (and sanctions avoided) when they accede to the directives of the center. Ownership in that situation is not the central consideration.

The Approach to Reform

Once it became apparent that the Federal Republic would be endowed with the privilege of independent action, the German reform was launched without delay. Some time had already passed, however, and significant consensus had been achieved that change was inescapable. The decentralization was initiated with the currency reform in 1948 and was essentially completed "with the achievement of full convertibility of the DM in 1958."[82] Erhard had a clear conception of what success required: a functioning price system and effective competition. Price stability and convertibility were seen as guarantors of success, and private ownership, freedom of commercial activity, and the freedom of agents to form coalitions were also seen as important."[83] In the view of Loesch, Erhard's "clear theory" about the structure and functioning of the new system made it possible for him to establish priorities and achieve an effective sequencing of necessary reform measures.[84]

It is clear that in Soviet perestroika some of the key elements of reform are still lacking, especially price reform. Nor can it be argued that the Soviets have based their approach to economic change on a well-developed methodology; they concede that they are groping their way.[85] Phase III will require clearer articulation of objectives and the creation of positive expectations among the populace in order to pave the way for greater acceptance of the important elements of reform that are still lacking and will need to be painfully implemented.

Investment Under Competent Bankers and Managers

An important difference in the German and Soviet reform experience is that the former country was much more generously endowed with managers and bankers who understood how best to manage capital. Even where individual entrepreneurs were too timid to commit needed capital to industrial investment, banks became involved with financing and even with the management of industry. To protect their interests they often participated in the selection of the directors and managers of firms, and were not disinclined to impose their own representatives upon large and cartelized firms. Some German economists have described this synergistic relationship as 'finance capitalism'.[86] If the Soviets are to succeed in Phase III, the search for more effective management (weaned from the ministerial system and able to carry out its own investment program) must be intensified from Phase II.

The "Human Factor"

There are some striking differences in the attitudes of workers, managers, government officials, and other economic agents when one compares the reform environments of postwar Germany and the contemporary Soviet Union. One of Gorbachev's greatest problems is what he terms the "human factor," which refers to the apathy, incredulity, mistrust, and hostility of the workers toward the party and the official economy. The Germans, too, were disillusioned with politics after the calamitous experience with Nazism, but they were prepared for a flight from politics into production and reconstruction. By 1948, they wanted only to cast off every sort of state regulation and to be free to exert their energies in a more liberal economic order.

The crushing defeat of the war had left no illusion that the peace and reconstruction would be pleasant. In Wallich's opinion, a highly equitable income distribution might have "overburdened the strong" causing all "to have sunk together." By being allowed to ameliorate their own position first, economically viable agents were put in a position to "pull the rest after them" in the general expansion of the economy. Gradually, wages and pensions followed profits, with the lag permitting the investments which accelerated reconstruction.[87] As a result, quickly after the dismantling of the centrally administered economy, Stolper observes, "expansionist forces were set free such as even the strongest believers in a free market economy had hardly anticipated.[88]

The modesty of German consumers and workers in that era made it unnecessary to translate immediate economic gains into consumer improvements, and this was not done. Moreover, the threat of unemployment, which contemporary Soviets fear and abhor, deterred anti-social behavior by the poorly motivated, if there were such in Germany's reconstruction era. It was not socially hazardous that the system produced inequalities of income, partly at the expense of labor, pensioners, refugees, and the unemployed. Wallich has interpreted the concentration of income as the price of high saving and high investment.[89]

The impressions of journalists and travelers about current conditions in the Soviet Union would not give rise to the expectation that past Soviet docility can be expected to continue indefinitely. The people of the Soviet Union have been forced over the decades to cope with the conditions of relative shortage, and their protest of apathy and poor workmanship gives rise to phenomena which did not confront Erhard. The continuation and worsening of the shortages is ubiquitously assumed to be hazardous for Gorbachev's leadership. It is a common concern that Soviet citizens are reaching the end of their patience.

Unfortunately, the shortages are not perestroika's only hazard. The reasoning throughout this paper is essentially that the reform effort can be improved by a judicious and well-timed application of additional, rather strong medicine. The paper does not address the issue of whether perestroika will actually be given the opportunity to inaugurate Phase III. Consumer disillusionment over prices, supply, and quality is scarcely the only potential hazard for Soviet reforms. The rebellious republics, the possibility of significant and debilitating labor unrest, as well as other sources of growing social unrest, all endanger perestroika's health and longevity. This observer does not know what a "failure of perestroika" might mean. He simply hopes that none of us will have to find out.

Notes

1. See P.J. Bryson, "Enterprise and Association in Soviet Planning: Comparisons with the East German Experience" in *East Germany in Comparative Perspective*, eds. D. Child, T. Baylis, I. Collier, M. Rueschemeyer, (London: Routledge), 1989, 163-189 for a treatment of the similarities between the plan "perfecting" approaches of the GDR and the USSR. In some cases, of course, the relevant measures shared common origins with previous Soviet proposals, so the Soviet expert would properly view these simply as recycled policies. I believe, however, that they were sometimes recycled because the East Germans seemed to demonstrate that with the proper implementation they could actually be made to function effectively.

2. J.M. Battle, "Uskorenie, Glasnost' and Perestroika: The Pattern of Reform under Gorbachev," *Soviet Studies*, 15, no. 3 (July, 1988), 376, cites a speech of Gorbachev to the Khabarovsk aktiv on July 31, 1986, in which the General Secretary adopts the practice of describing the restructuring process as revolutionary in nature, "a genuine revolution in the entire system of relations in society, in the minds and hearts of people."

3. Gorbachev explained, in a long, revealing address at the first meeting of the new Soviet parliament, some of the reasons why too few positive results were being achieved by the reform measures. He gave much blame to the finance system for being completely disorganized and the consumer market for being "out of control." In his words, "every possible inadequacy and consumer goods shortage and commodity panic generate strong, justified dissatisfaction and genuine social tension. For this there are various causes. This is the difficult heritage of the past and the great losses tied to the decline in world market prices for fuels, the tragedy of Chernobyl and natural disasters. But it is also certain, that the situation in the economy is actually tied in significant measure to our actions or our inaction in the years of restructuring. The state continues to live beyond its means. The expenditures of the five-year-plan budget are growing more rapidly than the national income." See "Mikhail Gorbatschow Gber die Grundrichtungen der Innen- und Aussenpolitik der UdSSR," *Neues Deutschland*, May 31, 1989, 4-6 (here 4). In other places, of course, Gorbachev cites failings other than the national financial problems that preoccupy him here.

4. See Gertrude Schroeder, "Gorbachev: 'Radically' Implementing Brezhnev's Reforms," *Soviet Economy*, 2, (1986), 289-310.

5. See *O korennoi perestroike upravleniay ekonomikoi: Sbornik dokumentov*, Moscow: Politizdat, 1987, see article 2.5, 6.

6. *Ibid.*, Article 2.1, 5.

7. See Ed A. Hewett, *Reforming the Soviet Economy: Equality vs. Efficiency*, Washington, D.C.: (The Brookings Institution), 1986, 345-346. He writes, "from the point of view of the reforms, whether this or the other administrative regulations work is not the point. They are all manifestations of the mentality according to which nothing happens unless the center orders it. Such measures are contrary to the reform; indeed they undermine it....(t)he leadership shall have to accept a situation such that if, for example, there are shortages of particular products, or a certain industry lags in technological progress, the minister involved, and local party officials, cannot be held fully accountable for the problems."

8. A. Aganbegyan, *Economic Challenge of Perestroika*, Bloomington, Indiana: University Press, 1988.

9. See *O korennoi perestroike, op. cit.*, Article 9.1.

10. *Ibid.*

11. *Ibid.*, Article 9.3.

12. B.P. Kurashvili, "Restructuring and the Enterprise," *Problems of Economics*, 31, 1988, 30.

13. O. Yun, "Sistema ekonomicheskikh normativov," *Gesellschafts-wissenschaftliche Beitraege*, (Summary of articles from *Ekonomischeskaya Gazeta*, 1987, Nos. 40, 38, 39, 47), 38, No. 1, 1988, 141-155.

14. As Kuraschvili (1988, 30) expresses it, "the enterprises 'have nowhere to go' and will accept the control figures that are conveyed to them just as they accepted the mandatory plan targets before the Law."

15. See especially paragraphs 4 through 6 of the new legislation, *O korennoi perestroike*, 1987, 60-61.

16. See Aganbegyan, 1988, 133.

17. In the words of Gorbachev, "Khode realizatsii reshenii XXVII cezda KPCC i zadachakh po uglubleniyu perestroiki," *Ekonomicheskaya Gazeta*, No. 27 (July, 1988), 3-15

(here 5), "much now depends on the reform of prices.... Without a reform of prices we cannot create normal economic relationships in the national economy, permitting a well-founded appraisal of the costs and revenues of production, equivalence of volumes of goods and services, the stimulation of scientific-technical progress and economy of resource utilization, a normalization of conditions in the market, and the achievement of justice in the distribution of labor incomes."

18. A. Aganbegyan, "Basic Directions of Perestroyka", *Soviet Economy*, 3, 1987, 282.

19. R.E. Ericson, "The New Enterprise Law", *The Harriman Institute Forum*, 1, No. 2., 1986, 3.

20. I strongly agree with Ericson's assessment of the new reform legislation, *viz.*, that "the enterprise Law clearly fails to establish sufficient economic freedom for the firm." Prices and normatives, he avers, "are not likely to bear any systematic relation to pure social values or scarcities." Prices are to be subject to "arbitrary surcharges and discounts based on criteria of engineering rather than economic quality....this deprives prices of the necessary flexibility and enterprises of the necessary discretion ..." See Richard E. Ericson, "The New Enterprise Law," *The Harriman Institute Forum*, 1, No. 2, 6.

21. Paragraph 4 of the section cited (156) confirms and emphasizes the desire, when reviewing the level of industry prices, to consider the "effectiveness, quality, technical-economic facets of the use characteristics of commodities" in price formation.

22. *O korennoi perestroike, op. cit.*, 153.

23. A. Deriabin, "Principles in the Restructuring of Price Formation," *Problems of Economics*, 30, no. 7, (July, 1987), 54, 55 allows that "most modifications in the pricing procedure or in the system of existing prices" do not move "in a consciously chosen direction, but are only a reaction (more often than not, an extremely belated reaction) to various kinds of changes in the economy." Draft prices are sent by the thousands to the USSR State Committee for Prices, which examines and approves them. The specialists in this department do not have enough time to analyze and correct the tens of millions of prices already in existence (they can devote less than a minute to each price).

24. *O korennoi perestroike, op. cit.*, Paragraph 8, 159.

25. See the interpretation of the new legislation by the Soviet economist A. Komin, "Zakon o predpriyatii i tsenoobrazovanie," *Gesellschafts-wissenschaftliche Beitraege*, (No.

2, February, 1988, 141-155), Summary of articles from *Ekonomicheskaya Gazeta,* 1987, Nos. 38, 39, 40, 47. Here, see 155.

26. Friedrich Haffner, "Ein Hauch von Marktwirtschaft im Plansystem. Die Neuen Reformversuche in der Sowjetunion." *Frankfurter Allgemeine Zeitung,* September 24, 1989, 15.

27. Council of Ministers of the USSR, "V Sovete Ministrov SSSR", *Pravda,* February 4, 1989, 1,2.

28. Gorbachev, "Mikhail Gorbatschow ueber die Grundrichtungen ," *op. cit.*, 4.

29. This point was brought forcefully to my attention by a Soviet economist who found the treatment on property in an early draft of this paper too weak.

30. P. Gumbel, "Soviet Deficit, Triple the Official Figure, Prompts Economist's Gloomy Assessment," *The Wall Street Journal,* January 26, 1989, A-10.

31. Mikhail Gorbachev, "Khode realizatsii reshenii XXVII cezda KPCC i zadachakh po uglubleniyu perestroiki," *Ekonomicheskaya Gazeta,* No. 27 1988, 5.

32. *Op. cit.*, 1988, 121.

33. See L.I. Abalkin and W.P. Loginow, "Erhohung der Arbeitsproduktivitt – Hauptweg zur Intensivierung der Wirtschaft," *Wirtschaftswissenschaft,* 37, No. 4, 1989, 500-516. They observe that a large number of workers in industry are lost because many are employed eliminating production errors with repairs, and about 1 million workers are busy as quality monitors. In agriculture about 5 million workers occupied with the production of 20 percent of output which will inevitably be wasted each year through poor storage and transportation. (See 504-505.)

34. See D. Kreshover, "Gorbachev and the Economy: The Developing Gameplan," *Gorbachev's Economic Plans,* Vol. 1, Joint Economic Committee, Congress of the United States, U.S. Government Printing Office, Washington, DC, November 23, 1987, 54-70. His assessment was that many of the policies unveiled to that time were "repeats" or "extensions of past ideas."

35. See "Mikhail Gorbatschow ueber die Grundrichtungen," *op. cit.*, 4.

36. *Ibid.*, 5. "Naturally," Gorbachev exclaimed, "the market is not almighty. Mankind has, however, brought forth no economic mechanism that could be more effective and democratic. Without it the socialist planned economy cannot be maintained." He also conceded that enterprises, concerns, cooperatives, and joint-stock companies (*Aktiengesellschaften*) must be the main actors in the economy.

37. For helpful discussions and insights on Soviet marketization plans, I am indebted to Natalia Khravlinskaya of Moscow State University.

38. For an interesting and instructive review of the Balcerowicz plan, see W.W. Jermakowicz, "The Beginnings of Social Market Economies in Germany and in Poland: A Comparative Approach," in *Zur Transformation von Wirtschaftssystemen: Von der Sozialistischen Planwirtschaft zur Sozialen Marktwirtschaft*, eds. A. SchGller and H.-G. Kr-Gsselberg, Forschungsstelle zum Vergleich wirtschaftlicher Lenkungssysteme, Philipps-Universitt Marburg, July, 1990, 71-85.

39. One should also remember that the Poles had brought down two previous socialist regimes when they tried to raise the prices of the subsidized necessaries.

40. *Ibid.*, 5.

41. See Oleg Bogomolov, "The Socialist World on the Path of Restructuring," *Problems of Economics*, July, 1988, 9.

42. *Ibid.*

43. I plead guilty to having once believed that the previous Hungarian-style reform might work. See my *Scarcity and Control in Socialism: Essays on East European Planning*, (Massachusetts: Lexington Books, 1976). Economists have seemed to believe that if the socialist economies had continued successfully with the initiatives of the 1960s, economic reform might have succeeded. We observed that reform failed when the *nomenklatura* successfully lobbied for its abandonment and a restoration of their rents and prerogatives. That may be true enough, but what we failed to notice was that in actual fact the reforms of the NEM, NES, or Kosygin/Liberman types would not have worked anyway. What was needed was not the reform of the socialist system, but system transformation. As Gorbachev has observed (but perhaps not yet fully believed), liberalization requires further liberalization until the entire planning apparatus of socialism is replaced by the market economy. There is no viable socialist planning system for the long term.

44. I admit my lack of expertise on socialist systems outside East Europe. Recent Chinese experience, however, seems clearly to demonstrate the folly of partial reform, i.e., of attempting to open an economy to change while insulating cultural and political institutions from the western peril.

45. Of course centralization and decentralization are relative concepts. There is no economy that is a "pure," decentralized economy. But the degree of central regulation and direction of the contemporary "mixed" economies differs substantially from the 1968 to 1988 Hungarian case, as we shall see.

46. This section leans heavily on and recommends warmly a recently translated, excellent little volume on the contributions in this early reform process of the famous Polish economist, Michal Kalecki. Jerzy Osiatynski's, *Michal Kalecki on a Socialist Economy*, New York: Saint Martin's Press, 1988, not only provides excellent insights into this important figure of the period, but reviews carefully the historical and theoretical problems attached to the reform attempt of interest here.

47. *Ibid.*, 15.

48. *Ibid.*, 30.

49. *Ibid.*, 37.

50. See Bela Belassa, "Reforming the New Economic Mechanism in Hungary," *Journal of Comparative Economics*, 7, 1983, 253.

51. See Janos Kornai's excellent and comprehensive article, "The Hungarian Reform Process: Visions, Hopes and Reality," *Journal of Economic Literature*, 24, No. 4 (December, 1986), 1687-1737 (here 1694). Much of the treatment of Hungary here is based on this article.

52. 13. See Janos Kornai, *Economics of Shortage*, Amsterdam: North-Holland, 1980. See also, Kornai, "The Hungarian Reform Process," *op. cit*, 1696-1697.

53. See Bela Belassa, "Reforming the New Economic Mechanism," *op.cit.*, 275.

54. This was attempted by equating the domestic prices of raw materials, fuels, and basic intermediate products to the tariff-inclusive import price in convertible-currency trade. See *Ibid.*, 254-255.

55. *Ibid.*, 269.

56. See Kornai, "The Hungarian Reform Process," *op. cit.*, 1706.

57. *Ibid.*, 1707.

58. *Ibid.*, 1700. When this happens, says Kornai, the market is an instrument" in the hands of the central policy maker. The central authorities "pull all the strings of indirect control and the profit-maximizing agents respond like obedient puppets.... Each string puller thinks that he can control the firm; the firm, confused by a hundred strings, starts to twitch. It does not respond clearly to bureaucratic regulation, but does not respond to market signals either," which constitutes the "illusion of regulation." See 1729.

59. Kornai provided a list of changes still needed after the 1980 reform round, and that list could almost be interpreted as a statement that one must simply introduce a market system. According to him "tough financial discipline, the hardening of the budget constraint, must be assured...more decentralization in the allocation of funds and with the creation of a flexible capital market...A commercial banking system must be fully developed...More competition must be allowed in export and import activities. Realistic exchange rates...import liberalization and full convertibility must be created...At the same time, the state must continue to play an active role in the economy. Its main obligations are the macro-management of demand, the regulation of monopolies, the development of the infrastructure, the protection of society against harmful externalities, the redistribution of personal income for the sake of social justice... The author of this paper is convinced that the implementation of these proposals is highly desirable....yet quite a few substantial questions are left open...what should be the future of non-state ownership and, in particular, private ownership...is the traditional form of state ownership compatible with the proposed changes listed above...? See *ibid.*, 1733.

60. An exception to the original oversight was made, appropriately by the West German economist, Dieter Loesch, "Ist der Sowjetsozialismus reformierbar?" *Orientierungen zur Wirtschafts- und Gesellschaftspolitik*, 38, (No. 4, 1988), 57-64. Loesch's discussion of similarities will be addressed presently. Since 1989 and the events that led to German reunification on October 3, 1990, of course, numerous West German authors have written about the West German (Walter Eucken, Paul Hensel, Ludwig Erhard *et al.*) contribution to system transformation.

61. See his "On the Theory of the Centrally Administered Economy: An Analysis of the German Experiment," *Economica*, New Series, (15) No. 58 (May, 1948), 79-100, and No. 59 (August, 1948), 173-93. The article appeared in Morris Bornstein, *Comparative Economic Systems: Models and Cases*, Revised Edition, Homewood, Illinois: Richard D. Irwin, 1969, 128-168.

62. *Ibid.*, 143.

63. See *ibid.*, 167. "Any use of the price mechanism for controlling the economic process sets a limit to the power of the central administration. There is a simple "either-or" alternative. *Either* the control is through prices, and therefore on the basis of the plans of households and firms, *or* it is based on the plans and valuations of a central authority. The two methods of control exclude one another."

64. Eucken himself said "the general freeing of prices would not merely have led to the development of new price relationships. The existing inflationary pressure would have led to a sharp rise in the general level of prices, to an appreciable fall in the value of money, to irrefutable wage claims, to obvious losses for savers, and to a rise in the cost of armaments. The tight hold on prices at their previous level, and the repression of inflation by pegging prices, became a dogmatically held principle of economic policy, as it has since become in other countries." *Ibid.*, 142.

65. As Henry C. Wallich, *Mainsprings of the German Revival*, New Haven: Yale University Press, 1955, 14, has indicated: "When prices for a short time rapidly inflated, there arose an international chorus of 'I told you so.' During the following period of rather slow progress and mounting unemployment, official pressure was exerted by the Allies for an expansionary policy. Time and again the lack of over-all planning was criticized. It was not until after the end of the Korea boom that the German policies were generally recognized as successful."

66. *Ibid.*, 160.

67. See Andrew Shonfield, *Modern Capitalism: The Changing Balance of Public and Private Power*, (New York and London: Oxford University Press, 1965), who felt that these agencies of private power

concentration, whose activities he referred to as "an embryonic planning exercise," needed only an economic plan to bring them together "into a working system." (See 264.)

68. Dieter Loesch, "Ist der Sowjetsozialismus reformierbar?" *Orientierungen zur Wirtschafts- und Gesellschaftspolitik*, 38, (No. 4, 1988), 57-64.

69. Postan, M.M., *An Economic History of Western Europe 1945-1964*, London: The Chaucer Press, 1967, 24.

70. Gustav Stolper, Karl Haeuser, and Knut Borchardt, *The German Economy: 1870 to the Present*, New York: Harcourt, Brace & World, Inc., 1967, 211, recount: "it was decided that the Reichsmark would be abolished and a new payment unit, the Deutsche Marck (D-Mark or DM), introduced. June 20, 1948, was the day when the event, long awaited by the German population but kept secret until the preceding day, finally came to pass. On this memorable Sunday every inhabitant of the three Western zonens was handed—together with his ration cards—40 Deutsche Marks in exchange for 40 Reichsmarks. On the day the new currency was born every person owned the same amount of money. But the very next day efforts began to increase the sum through gainful work. What seemed almost incredible happened. Literally from one day to the next fresh vegetables appeared in the windows of the food stores empty for years; shoes, clothing and underwear, unobtainable for money the Saturday before, could once more be bought."

71. *Ibid.*, 228.

72. See *O Korennoi Perestroike Upravleniya Ekonomikoi: Sbornik Dokumentov*, (Moscow: Politizdatt, 1987), article 6, section 3, 13.

73. See Stolper *et. al.*, 204. They point out, too, that since the Allies at that point were still seeking ways to save German economic unity, they postponed reforms until parallel actions could be taken in all four zones.

74. As Stolper *et. al.*, point out, Erhard had some evidence that decontrol need not be disastrous. "One year before, another liberal, the economist and later President of Italy, Luigi Einaudi, had courageously led his country in the same experiment. Experience in Italy had shown that with the end of rationing, strong energies were at once released, which benefited production and stimulated workers and entrepreneurs to provide the markets with greatly increased supplies. See *ibid.*, 213.

75. *Ibid.*, 204. Stolper *et. al.* remind that "government regulation of the economy had been introduced by the National Socialists as earaly as 1935 when several raw materials were becoming scarce. A year later a general price and wage freeze was resorted to.

Since that time, for more than ten years, prices and price relation between various goods had been held artificially stable."

76. This judgement by Wallich is not an exceptionally daring one. See Wallich, *op. ciit.*, 2.

77. See *ibid.*, 16.

78. See James R. Millar, "The Little Deal: Brezhnev's Contribution to Acquisitive Socialism," *Slavic Review*, 44, (No. 4, Winter), 1989, 694-706.

79. *Ibid.*, 206.

80. Eucken, *op. cit.*, Bornstein version, 130.

81. Stolper, *op. cit.*, 203.

82. Loesch, *op. cit.*, 58.

83. *Ibid.*, 58.

84. According to Loesch, "the general interdependencies of the institutional structures of an economic system lead inevitably to the result that isolated reform steps remain without effect, since the continued existence of structures of the old system block their effectiveness." (See *ibid.*, 59.)

85. Some have been more willing to claim that the reform efforts have been assisted by some conceptual guidelines, and the writings of Abalkin, Aganbegyan and Bogomolov seem to provide guidelines not markedly inferior to those of Liberman's in the reform of the 1960s. See Phillip J. Bryson, "Soviet Economic and Social Reform (*Perestroika* and *Glasnost*): Claim and Reality," forthcoming in *Wirtschaftssysteme im Umbruch: Markt- und Planwirtschaften zwischen Anpassungszwang und nationalem Reformbedarf*, ed. Dieter Cassel, Munich: Vahlen Verlag, 1990, 123-52.

86. Postan, *op. cit.*, 267.

87. Wallich, *op. cit.*, 19.

88. See Stolper, *et. al.*, *op. cit.*, 204. According to these authors, the willingness of the Germans to accept low wages and forego strikes "made possible a high level of profits, saving, and investment that greatly aided the build-up of industry.... The unions' concentration on the somewhat esoteric goal of codetermination-participation in management-may also have played a role." (See 12).

89. Wallich, *op. cit.*, 18.