

# GORBACHEV AND PERESTROIKA

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Mikhail Gorbachev inherited an economy with a sagging rate of industrial and agricultural output. He discovered, however, that once the Soviet Union fell behind, there was no easy way to catch up — especially in the age of high technology. His first task was to restore confidence. That meant sustaining the economic growth that Andropov had begun, but which lagged under Chernenko.

The Soviet leader did this by stressing psychological incentives and focusing on the need for improved worker discipline. He initiated a crackdown on alcoholism that went far beyond what Andropov had attempted. The sale of alcohol was banned before 2:00 p.m., and the number of liquor outlets was sharply curtailed. This had an immediate impact on industrial growth, which recovered rapidly from the decline that began in Brezhnev's latter years.

The emphasis on discipline and the crackdown on drinking was particularly important in increasing the production of petroleum. Output had begun to decline in late 1983. By 1985, production for the year was down 3 percent. In an effort to restore production, Gorbachev traveled to the main production fields in Western Siberia and insisted on better quality and less vodka. He followed up his visit with the wholesale firing of local Party and petroleum industry officials. The drop in petroleum output came to a halt, and one year later, production was up rather than down by 3 percent.

The visit to Western Siberia involved more than just a crackdown. Gorbachev also sought to stress the positive. He embarked on visits throughout the country urging people everywhere to work harder, warning them that if they did not do their best, the country would suffer. He became ubiquitous, appearing in remote regions which had never had a personal visit from a Soviet leader, or for that matter a Russian tsar.

But words and wishful thinking are not enough. Gradually, Gorbachev recognized that he must take forceful, albeit counter-revolutionary action. Only by yanking the Soviet economic system by its roots, could Gorbachev hope to break the gridlock the Soviet economy has created for itself. Thus, beginning in late 1986, he began sketching a series of proposals for reform which culminated in the more extensive program, designated *perestroika*, which he presented to a plenum of the Central Committee of the Communist Party in June 1987.

Not all of his proposals mesh properly. Moreover, some of his ideas have met resistance and therefore have been delayed. For that reason the bulk of

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the ideas will not start until 1991, the compromise date, and there is reason to question whether he will succeed even then. At the same time, he may introduce some additional reforms. As of now, however, we have a reasonable idea of his overall scheme.

Gorbachev's main priority is to diminish the role of administrative decision-making. That means sharply curtailing, but not eliminating the role of *Gosplan*, the state planning organization, and the ministries. To fill the vacuum, Gorbachev has sought to transfer economic planning to the periphery, that is, to the enterprise itself. This decentralized decision-making is to be guided by a more meaningful set of prices for raw materials, labor, and finished products. Unlike the past, when prices were based on a cost plus basis, prices in the future are also to reflect demand. Moreover, enterprises will have to learn how to worry about reducing costs. Whereas in the past, for all intents and purposes there was no such thing as bankruptcy, henceforth Soviet enterprises must earn a profit. They are to be self-financing — they must finance themselves with their own profits, depreciation, and if need be, repayable loans. They can no longer count on continuing subsidies from the state budget. Those enterprises that operate in the red will be declared bankrupt and closed down.

With time, enterprise managers will also be given more power to choose what they will produce. That may entail a different product mix than what would have been prescribed by *Gosplan*. Since the enterprise will also have to worry about costs, that may also mean firing workers. Enterprises, particularly large ones, are to be given the power to enter foreign export and import markets directly. Some seventy enterprises already have the right, at least on paper, to import and export without involving themselves with the Ministry of Foreign Trade, which until recently had a monopoly on all foreign transactions.

The meaning and importance of the ruble will be enhanced further because factories which hold rubles will use these for the purchase of supplies and machinery. In the past, that was not the case. Heretofore the allocation of resources had been determined centrally. What counted was not how many rubles one had, but how many allocation or ration coupons one had been authorized by officials in Moscow. To make this shift away from ration allotments meaningful, wholesale warehouses will be established, which will sell production materials to ruble holders independently of the ministries. If successful, these warehouses should go a long way in eliminating both supply bottlenecks and hoarding.

In the same way, access to credit will be decentralized. *Gosbank's* monopoly will be abolished and several banks will be created to finance existing and new industrial undertakings. These banks, like the factories, will operate on a profit and loss basis. A tax will be set and anything earned above that will become the property of the enterprise. The proceeds may then be used for wage bonuses, improved housing for the employees, or purchases of additional plants and equipment.

Finally, to generate an even greater sense of loyalty and involvement in the work place, managers and foremen are to be elected by secret ballot from among several candidates. In large factories, a labor collective may be elected from the ranks to make the actual decisions.

If implemented, these steps will mark a sharp change in the way Soviet enterprises have traditionally operated. Even more radical, if that word can be used in this context, is the decision to authorize private business and services, and joint ventures on Soviet territory with partners, not only from Eastern Europe, but the capitalist world. Admittedly, Soviet authorities have imposed strict limits on what these new private entrepreneurs can do. For example, they cannot hire any employees other than from within the family — and those only if they are pensioners or students. They can only operate their businesses after they have finished their regular state jobs. Joint ventures are to be similarly circumscribed. Foreigners may hold no more than 49 percent of the equity and both the president and chief operating officer must be a Soviet citizen. Nor is it a selling point to potential investors in the West that the repatriation of profits outside the Soviet Union is discouraged. Yet neither private businesses nor joint ventures have been allowed since Lenin introduced the NEP (New Economic Policy) in the 1920s. Unlike Lenin, Gorbachev has not rationalized these moves by calling them a step backward in order to take two steps forward; evidently, he regards these measures entirely as a step forward.

Certainly Gorbachev has to be praised for the boldness and far-reaching nature of his reform proposals. If asked to serve as his economic consultant, I would have prescribed much the same medicine. However, what may make sense on paper is not always politically or practically acceptable. Because the nature of the changes he is seeking is so radical, he has relatively little time to produce results. He also has to resolve a whole series of managerial dilemmas that would baffle even the most resourceful manager.

Given his determination to succeed, Gorbachev's dilemma is that he may have moved too fast, even though at the same time he may not have moved fast enough. That paradox is explained by the fact that his proposals are so far-reaching that they threaten almost everyone. Workers will have to work harder or face pay cuts or even discharge; managers may be voted out of a job, and ministers and bureaucrats offices may be closed down. If the approach to the reforms had been gradual, perhaps so many people might not have been alienated at once.

At the same time, Gorbachev has not been able to move fast enough to demonstrate that all this experimentation and disruption is worth the effort. Statistics, on-site inspection, and discussion with Soviet friends reveal little improvement beyond what normally takes place year-to-year. As B. N. Yeltsin, the head of the Moscow Party Organization, and one of the most outspoken leaders of the Party acknowledged in March 1987, "Our people have not felt substantial changes." Gorbachev himself concedes this problem. In a speech just prior to the one made by Yeltsin, he admitted that "everybody is

calling for restructuring . . . but what has it produced?" This is being asked not only by those opposed to restructuring, "but also by those who are for restructuring."

Unlike the Soviet people, we in the United States sometimes forget that this is not the first reformer the Soviet Union has had. Admittedly the current Soviet leader is much more ambitious and is reaching much further than his predecessors. But the complaint being heard in Moscow is that while the reformers always call on the workers to make the first sacrifice, in the past at least, the workers seldom received any benefits. If Gorbachev is to succeed, he must show quickly that his reforms have produced results, particularly an improvement in housing and in the availability and distribution of consumer goods. Otherwise, he will have no meaningful support base for his efforts.

Gorbachev has a catch-22 problem. The workers will not work harder unless they see there are more abundant and more desirable goods to buy with the money they earn. Yet it is all but impossible to produce more and better goods without worker involvement. The Soviet industrial infrastructure has deteriorated so that even if the workers decided they wanted to work harder and better, they would still find themselves frustrated by the machinery they must work with. For the most part, it is ill-designed, imprecise, and wasteful. Thus even with the best of intentions, it would be hard in two or three year's time to produce goods that meet world standards.

The same barrier makes it impossible to improve in any meaningful way the distribution and sale of consumer goods. The Soviets have systematically deprived the consumer distribution network of adequate resources. There are simply not enough stores, warehouses, and other facilities. Even with world class management, these shortcomings cannot be remedied overnight or even in four or five years. The big unknown is whether Gorbachev has that long.

Gorbachev needs to stop the practice of increasing workers' wages faster than productivity. But as wages are cut, worker morale and product quality will decline. For example, with the power to reject poor quality output, Gorbachev sent state inspectors to 1,500 of the Soviet Union's largest factories. Once rejected, the goods produced were not included as part of plan fulfillment. Bonuses were not paid and salaries in some of the Soviet Union's largest factories fell 2-10 percent during the first quarter of 1987. In Western economies, poor quality is usually flushed out of the market because no one buys the goods. But that is a risky and time-consuming strategy in the Soviet Union, where goods have traditionally been in short supply. So Gorbachev acted like his predecessors while ignoring his own guidelines for greater use of market forces. By sending out the bureaucrats from Moscow, he did not set a good example of what the reform is supposed to mean.

Another concern is providing incentives to factory managers as well as peasants and farm managers. Gorbachev and his advisors have been warning that prices will have to become more meaningful. But if Gorbachev is to eliminate what he says is a 70 billion ruble (\$110 billion) annual subsidy on consumer goods, that will necessitate a twenty to thirtyfold increase in housing costs and almost a threefold increase in meat prices. As the Polish leadership

can affirm, such price hikes can be politically explosive. For that matter, the reason why meat prices in the Soviet Union have been unchanged since 1962 is that the price changes then ignited riots, necessitating a mobilization of Soviet troops which resulted in shootings and loss of life.

An increase in unemployment will produce the same result. The implicit social contract in the Soviet Union provides that in exchange for relatively slow improvement in the standard of living and restricted personal prerogatives, there will be no explicit inflation or unemployment. That is why Gorbachev has attacked those in and outside the Soviet Union who have warned that a meaningful reform will necessitate a minimum unemployment rate of 2.5 to 3.5 percent. Unless he faces up squarely to price increases and unemployment, neither of which is likely to be accepted by the Soviet population without violent protest, Gorbachev will not rid himself of unproductive workers or undesirable products, and he will not stimulate productivity or the invention and production of new and more desirable goods.

The Soviet people have also accommodated themselves to the fact that income for most workers will be relatively equal. In the past, an exception was made for Party officials. It was not that Party officials' incomes were so much higher than average, but that they had access to special shops and privileges. As often as not, high incomes were associated with illegal dealings in the second economy or the black market.

Now Gorbachev wants to encourage initiative and reward it with higher incomes. But despite his best efforts, displays of wealth are regarded as indicative of unethical practices and invite police crackdowns. For example, the operation of a private taxi cooperative in Krasnoyarsk was ordered closed because the drivers were earning too much money. No wonder that of the twenty state taxi cab drivers I interviewed in Moscow and Leningrad in the summer of 1987, absolutely none thought that there would be more than a very few private cabs in their cities. Some insisted there would be none. Gorbachev is espousing an enrich-yourself mentality after many years of opposition to it. It remains to be seen whether ideological conservatives will accommodate themselves to income differentiation, inflation, and unemployment.

In addition to infusing market techniques into the Soviet economy, Gorbachev intends to show that the Soviet Union will have a more democratic economic system than any other country in the world, be it communist or capitalist. He has called not only for the secret election of the factory managers, but also of the shop foremen. However, if they have their own political mandate, the shop foremen may not respond to orders from the factory managers. Such issues highlight the dilemma of making the workers feel involved and stimulating a sense of partnership without destroying necessary managerial prerogatives.

Gorbachev has said that the ruble should be convertible. While the Ministry of Foreign Trade's monopoly over all foreign trade has proven to be a stifling bottleneck, it has on the whole helped the Soviet Union to avoid large balance of trade deficits. In the first seventy years of the Soviet state, imports from

the outside world have been severely circumscribed. It may be problematic for the Soviet Union to avoid large trade deficits if Soviet individuals and enterprises are allowed to import or export what they want freely.

In order to increase Soviet exports and facilitate its mastery of high technology, Gorbachev is promoting the ideologically suspect joint ventures. But to avoid provoking Soviet conservatives more than they have been already, Gorbachev's subordinates are insisting on a host of cumbersome restrictions. These limitations, however, scare off foreign investors. At this writing, only seven joint ventures have been approved. Moreover, all of them are rather minor in scope and involve low, not high technology. The most sophisticated is a factory producing commercial refrigeration units. More typical are the timber operations in Siberia, and a hotel and an Indian restaurant in Moscow. It is doubtful that there will be anything else as long as the foreign partner is unable to exercise quality control and to assure himself of profit repatriation. The infusion of necessary technology may not be obtainable without risking an ideological backlash.

The keystone of Gorbachev's reforms is his call for a sharp contraction of the powers of *Gosplan* and the ministries. However, as long as the factory manager is beholden to the ministry and *Gosplan* for production components and other inputs, the enterprise managers will find that they still lack the powers to determine their output mix. Admittedly, most countries combine some degree of central guidance and influence with managerial independence. But a mix of central guidance and autonomy is much more difficult to promote when a society is attempting to move away from central planning than when it has never had it. As long as the authorities in Moscow have the ability to disburse favors, phone calls from Moscow will usually be treated with preference, regardless of what the market might dictate instead. Thus, the fundamental bureaucratic hurdle to the reforms consists of reconstituting managers of enterprises so that after six decades of having learned how to respond to ministerial and other central wishes and commands, they will willingly ignore those wishes and the subtle hints of those at the center.

Gorbachev will have to make some tough choices in the months ahead. Like other managers around the world, he has discovered that upending a system that has resisted change for over sixty years is not easy. No matter what options he chooses, he undoubtedly will encounter domestic opposition. As he himself has put it, the far-reaching nature of his restructuring program has meant that there are many "who have had their toes stepped on" and who as a consequence are very much opposed to these reforms. Acknowledging that there may be more opponents than supporters, Gorbachev has reiterated over and over again that "the next two to three years will be the most difficult." Given the magnitude of his task, the odds that he will succeed do not seem to be in his favor.