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Perestroyka and Its Implications for European Socialist Countries

Bela Balassa

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Perestroyka, introduced in the Soviet Union to reform the economy after the "period of stagnation" under Brezhnev, involves combining centralized planning with elements of a market economy. For it to succeed, certain micro and macro conditions need to be fulfilled.

As far as micro conditions are concerned, one should emphasize the interdependence of rational prices, decentralization, profit maximization, incentives, and competition. For commodities produced domestically, the establishment of rational prices requires that prices equate demand and supply. This, in turn, necessitates the decentralization of decision-making and profit maximization by the firm. At the same time, managers would have to be provided with appropriate incentives in order to ensure that firms maximize profits. Finally, there is need for competition to guarantee that profit maximization does not lead to the exploitation of monopoly positions and inflation.

Various macroeconomic conditions also need to be fulfilled for perestroyka to succeed. The government should aim at realistic growth rates, establish a balance between investment and consumption, eliminate the overhang in the market for consumer goods and services, and drastically reduce the budget deficit.

At the same time, the success or failure of perestroyka will have implications for the success of reforms in the European socialist countries. And the performance of these economies will be affected by the increased demand for quality in the Soviet Union. But successful reform efforts on their part will help to meet this demand to exploit the opportunities offered by the vast Soviet market.

PERESTROYKA AND ITS IMPLICATIONS
FOR EUROPEAN SOCIALIST COUNTRIES

Bela Balassa *

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PERESTROYKA AND ITS IMPLICATIONS FOR

EUROPEAN SOCIALIST COUNTRIES

Bela Balassa

This paper provides a critical evaluation of perestroyka (restructuring) in the Soviet Union and examines its implications for the European socialist countries. Perestroyka was introduced to reform the Soviet economy after the "period of stagnation" under Brezhnev. It involves combining centralized planning with elements of a market economy.

Section I of the paper describes the main elements of the Soviet economic reforms. Sections II and III, respectively, analyze the micro and the macro conditions of the success of the reforms. Section IV discusses the implications of the reforms for the European socialist countries.

I. The Main Elements of Perestroyka

The basic document of perestroyka is the Osnovnye polozheniia (Basic Provisions) approved by the Central Committee Plenum of the Communist Party of the Soviet Union in June 1987. This was followed by further documents, of which the Law on the State Enterprise, enacted in July 1987, is the most important.

The Basic Provisions emphasize that the economy will continue to be centrally planned and managed as "a unified economic complex." Its goals and priorities are set by a fifteen year plan that serves as a basis for the detailed formulation of the plan for the initial five year period, with a breakdown by years. The plan is prepared by the State Planning Committee (GOSPLAN) and divided among the ministries that, in turn, provide indicative planning data for the firms, on the basis of which these work out their own five year and annual plans.

The ministries have been subordinated to seven superministries. At the same time, sectoral subbranches of the ministries are being replaced by several thousand large associations and enterprises, established by amalgamating existing enterprises. The newly-created large groupings incorporate all phases of the manufacturing process, from research to production to marketing.

While the transfer of the functions of the subbranches of the ministries reduce their operational responsibilities, the ministries continue to have an important role in the planning process. Thus, according to the Basic Provisions, the ministry "is responsible to the nation for satisfying demand for the branch's product, preventing disproportions, ensuring that the product meets world technical and quality standards, and working out and implementing branch scientific and technical programs."

The ministry influences firm behavior by setting

> "1. 'Non-binding control figures' that specify the value of output, total profits, foreign currency receipts, and 'major indicators of scientific and technical progress and social development,' a list to be fixed by the Council of Ministers.
>
> 2. A mandatory bill of state orders for output that includes commissionings of facilities financed by state centralized investment and products essential for fulfilling priority state tasks for 'social development, scientific-technical progress, defence, and deliveries of farm products.'
>
> 3. Limits, which include normatives according to a list approved by the Council of Ministers, regulating such matters as growth of total wages and the allocation of profit among various kinds of taxes and funds" (Schroeder, 1988, pp. 56-57).

Apart from the state orders, firms are to sell their products freely to other firms and to wholesale trade organizations. In turn, aside from basic materials and investment goods that continue to be rationed, they are to buy their materials from other firms and from wholesale trade organizations.

The firm's plan is based on the control figures, mandatory state orders, economic normatives, and contracts with customers and suppliers. The Law on the State Enterprise states that "the enterprise is obligated to strictly observe plan discipline and meet plans and contractual obligations in full." It further states that "fulfilment of orders and contracts serves as the most important criterion for evaluating the activities of the enterprise and providing material rewards for its employees."

The firm is subject to "full economic accountability and self-finance." This means that the firm will not receive subsidies and it will finance all its current and capital expenditures from its sales revenues. Firms that continually make losses are to be liquidated.

The Basic Provisions also modify the process of price formation. For basic products, prices are set centrally on the basis of "socially necessary expenses of production and sale, utility, quality, and effective demand," for a period of five years. They are to cover the costs of the enterprises, including payments for natural resources, labor, and capital. For the remaining products, contract prices are to be determined by the enterprises. But these prices are subject to control and should be set on the same basis as the centrally determined prices.

Producer prices and consumer prices continue to be divorced from each other. Food prices are maintained low by the use of state subsidies which may amount to as much as two-thirds of the producer price. In turn, industrial products are often subject to high taxes.

Under perestroyka, foreign trade has been decentralized. By 1989, all enterprises producing competitive products can trade directly with foreign firms. However, the prices received and paid by Soviet enterprises are divorced from world market prices by the use of conversion factors that vary among products. Also, exceptions from direct trading by enterprises include petroleum, raw materials, steel products, chemicals, grains, and food products. Also, while exporters are supposed to use part of their foreign exchange earnings to import materials and machinery, in practice imports continue to be subject to controls.

The Basic Provisions and the Law of the State Enterprise do not specifically concern agriculture. Agricultural reform was to be carried out in the framework of two major decrees. The first, adopted in November 1985, established GOSAPROM, a superministry for agriculture that has subsequently been abolished because of the excessive bureaucracy it created. The second decree, adopted in March 1986, permits state and collective farms to sell a larger proportion of their output at market prices and endorses the use of production contracts.

In August 1988, it was stated that individual farmers can lease land up to fifty years from state and collective farms. Furthermore, in August 1989, it was declared that state and collective farms can sell above-plan output for foreign exchange.

The law adopted by the Supreme Soviet in November 1986 stated the conditions under which co-operatives can be established. The law provides possibilities for the establishment of co-operatives in a variety of areas but permits state employees to participate in the operation of co-operatives only outside working hours.

II. The Micro-Conditions for the Success of Perestroyka

For perestroyka to succeed, certain micro-conditons would need to be fulfilled. In this connection, one should emphasize the interdependence of rational prices, decentralization, profit maximization, incentives, and competition. For commodities produced domestically, the establishment of rational prices requires that prices equate demand and supply. This, in turn, necessitates the decentralization of decision-making and profit maximization by the firm. At the same time, managers would have to be provided with appropriate incentives in order to ensure that firms maximize profits. Finally, there is need for competition to guarantee that profit maximization does not lead to the exploitation of monopoly positions and inflation.

1. The Establishment of Rational Prices

The price reform, originally planned for 1988, has been stponed. The implications of maintaining existing distorted prices have been well-stated by Hewett: "That gives enterprises several years to operate with distorted prices that will arbitrarily give profits to some enterprises and losses to others. That, in turn, gives enterprise directors ample ammunition to argue for exceptions (special subsidies or tax breaks), which could set the tone for the next decade or so." (1988, p. 356).

But the planned price reforms do not provide a solution either. Controlled prices will be set on the basis of average costs, so that they will not equate supply and demand, and they will remain unchanged for five years, thereby imparting rigidity to the pricing system. Nor will contractual prices equate supply and demand since they are also supposed to be set on the basis of production costs.

At the same time, to the extent that enterprises set prices, there appears to be a tendency for price increases. Existing regulations permit raising prices by 15 percent for new or particularly fashionable products. But, "new" products may represent little modification from "old" products.

And, the existing situation of excess demand, together with monopolistic structures to be discussed below, have led to increases in the prices of "old" products as well. This explains the introduction of price controls in 1989 (Financial Times, February 4, 1989). Price controls, then, introduce additional rigidities in the price setting process.

At the same time, as noted above, prices at the consumer level are divorced from prices at the producer level by the use of taxes and subsidies. Yet, the two sets of prices should be linked in order for consumer demand to influence producer decisions. This would necessitate equalizing rates of turnover taxes across the board and eliminating consumer subsidies.

Also, prices on the producer level would have to be determined on the market. This, in turn, requires that the other micro conditions be fulfilled. These will be discussed in the following.

2. Decentralization

The reform leaves the central planning apparatus and the ministries in place. In fact, the establishment of the superministries represents centralization rather than decentralization. As Hewett noted, "these supraministerial organs will eventually assume important planning functions for their complexes, as Gosplan takes on the more general role of focusing on the entire economy, which includes coordinating relations among the complexes. Presumably this will involve constructing balances for the key products in the complex, allocating investment, reorganizing the sector, and so on" (1988, p. 338).

At the same time, ministries continue to be judged on the basis of meeting output targets. Thus, at a meeting of the Council of Ministers, held in January 1989, "a string of senior ministers ... were publicly reprimanded for failing to supply consumer goods up to the state-planned targets" (Financial Times, January 16, 1989). With the ministries being held responsible for fulfilling the output plan, it is hardly surprising that they try to hold enterprises to their output plan. Thus, Gregory may not greatly exaggerate in making the following statement.

> "Ministries are still judged on the basis of aggregated physical outputs in the same detail as before. Unless perestroika alters in a fundamental way the manner in which ministries are judged, it is foolish to expect a fundamental change in ministry dealings with the enterprises. The ministry will wish to maintain traditional levers over its enterprises. Ministry officials note that if they are to continue to have compulsory targets, they must continue to assign compulsory targets to their enterprises" (Gregory, 1989, p. 6).

The ministries can influence enterprise actions by making the "non-binding control figures" binding, by relying on state orders, and by setting the normatives for the enterprise. Particular importance attaches to state orders that are based on the plan. In effect, the state guarantees markets and supplies. At the same time, operating outside the state-order network is risky. While buyers are easy to find, it is very difficult to obtain materials for production that is not covered by state orders.

Normatives cover the share of profits going to the state, the ministry, and the enterprise; the size of the wage fund; and charges for working capital, the use of natural resources etc. As normatives are set separately for each enterprise, the ministries can use them to ensure conforming behavior by the enterprise. They are also subject to bargaining in a situation where distorted prices affect the financial profitability of the enterprise.

In order to avoid these adverse consequences, price determination on the market would have to be accompanied by the abolition of the control figures and the equalization of normatives across enterprises. To the extent that initial conditions differ among firms, this should be taken into account in the valuation of their capital.

Also, state orders should be reduced to a minimum. This, in turn, requires abolishing the responsibility of the ministries for output targets. Output should be determined on the market as firms seek to cater to demand in the pursuit of profits.

3. Profit Maximization

In the Soviet Union, profits were introduced alongside with output as firm targets during the Kosygin reforms. Nevertheless, output remained as the principal indicator of the firm's success.

Profitability would play an important role under the reform since continuing losses would bring the firm into bankruptcy. However, as noted above, under distorted prices, profitability indicators are also distorted. This, in turn, gives rise to bargaining with the supervising ministries.

At the same time, for the supervising ministries, output remains the main success indicator. This means that the ministries will want to force firms to meet output targets. The firms will be inclined to do so in order to get favorable treatment from the supervising ministry. Such will not be the case if the ministries do not have output targets as suggested above.

4. Incentives

In the past, managers' bonuses depended on firm plan fulfillment and on various indicators set by the supervising ministry. This situation hardly changes under the reform, thereby reducing the interest of the managers in maximizing profits. In order to do so, managers should be given a share in profits.

Profit sharing should not be instituted, however, for the workers since profits are the result of actions taken by managers rather than the workers. At the same time, it would be desirable to generalize the piece wage system, under which the workers are remunerated for their contribution to the firm's production.

5. Competition

In the traditional centrally planned system, there is no competition as the transfer of products is regulated by the plan. The introduction of firm-to-firm relations could ideally give rise to competition. This is not the case in the Soviet Union, however.

To begin with, there is no competition from imports. Also, the establishment of a few thousand vertically integrated enterprises gives rise to monopoly positions. At the same time, conditions for entry are controlled by the ministries. And, on the part of the ministries, no encouragement is given to enterprises to produce outside their allotted product composition.

The lack of competition interferes with the efficiency of resource allocation even if all other conditions are fulfilled. Furthermore, inflationary pressures are generated. It has been reported that "a poll conducted in late 1988 among managers of industrial enterprises revealed that 10 percent intend to reduce output by 15-20 percent and raise their prices even more, so that output measured in current prices will increase nevertheless" (Popov, 1989, p. 6).

Nor can one expect competition by the co-operatives. This is because the co-operatives produce services and, to a lesser extent, consumer goods which are not available or are not available in sufficient quantities. At the same time, after their initial successes, the activities of the co-operatives have been circumscribed, price control has been imposed, and taxes on income derived from co-operatives raised.

The strictest rules have been imposed on the flourishing medical co-operatives. A range of medical activities, such as observation and treatment of pregnancy, surgery, the treatment of infectious diseases, and the treatment of drug addiction, have been banned and any other medical aid can be offered only on the basis of a contract with a medical institution. The decree also bans co-operative schools, the production or the hiring of video films, publishing books on science, art, and literature, and the manufacture and sale of religious items. In addition, a whole range of activities, including all other publishing, organizing concerts, artistic events, and other forms of entertainment, and tourism services will only be allowed if the co-operative has a contract with a state enterprise (Financial Times, January 6 and 17, 1989).

Also, price controls have been imposed on the co-operatives. In the event that cheap state supplies are used, co-operatives are not supposed to charge more than state prices. Also, in response to high charges in co-operative restaurants and cafes, local councils will set maximum mark-ups (Financial Times, February 4, 1989).

Finally, income tax rates have been raised to a considerable extent from the earlier level of 13 percent. The highest marginal rate has been set at 50 percent. This will apply to a large extent to incomes derived from co-operative activities.

These considerations indicate a lackadasical attitude on the part of the government vis-à-vis the co-operatives. While some economists projected that the co-operatives may eventually provide 10-15 percent of national income, the success of the co-operatives and the high incomes they have obtained has been greeted with dismay. Thus, it is doubtful that the contribution of the co-operatives will increase much further.

Yet, for perestroyka to be successful, more freedom would need to be given to the co-operatives and their activities be extended to a wide range of manufacturing products. It would further be necessary to reverse the process of industrial concentration and to establish the conditions of genuine competition.

III. The Macro-Conditions for the Success of Perestroyka

For perestroyka to succeed, certain macro-conditions would also need to be fulfilled. The government should aim at realistic growth rates, establish a balance between investment and consumption, eliminate the overhang in the market for consumer goods and services, and drastically reduce the budget deficit. These conditions will be discussed in the following.

1. Setting Realistic Growth Rates

Gorbachev's new economic strategy is said to be summed up in the new political concepts of "uskorenie" (acceleration), "perestroyka" (restructuring), and "glasnost" (openness). In fact, the twelfth five year plan for the period 1986-90 aims at a considerable acceleration of economic growth. For the period as a whole, GDP is projected to rise by 22 percent, compared with 16.5 percent in 1981-85. A substantial part of this increase would be accomplished by the rise in efficiency by 15 percent, compared with 7.5 percent in the preceding period (Aganbegyan, 1988, pp. 1, 10).

These projections are not realistic. As we have seen, the economic reform has not progressed far, so that there is no basis for the projected improvement in efficiency. In fact, the dislocations created by the reform efforts and their lack of consistency have led to a slowdown in efficiency improvements. Thus, in the short run, there is a conflict between "uskorenie" and "perestroyka."

If improvements in efficiency slow down, increases in output would to a large extent be accomplished through increases in resources. Resource availabilities will, however, increase to a lesser extent than beforehand, because of the deceleration of the growth of the labor supply and the limited availability of natural resources. According to the Five Year Plan, resources would increase by 7 percent in 1986-90, compared with 9 percent in 1981-85 (Ibid).

This being the case, aiming at high economic growth rates only exacerbates the excess demand prevalent in the Soviet economy. Excess demand, in turn, creates disproportions among industries, adds to inflationary pressure, and does not permit the market mechanism to operate satisfactorily.

There is need, therefore, to eliminate the excess demand existing in the economy. Apart from reducing the budget deficit and eliminating the overhang in the market for consumer goods, to be discussed below, this will necessitate avoiding excessive plan targets and reforming the credit system.

In recent years, credit provided for enterprises increased much more rapidly than production. According to Aganbegyan, in some years the volume of credit increased by 15-17 percent while output grew by 3-5 percent (1988, p. 138). At the same time, the repayment of credit was not ensured, thereby adding to the liquidity of the enterprises. There is need to develop a new credit policy that avoids creating excess liquidity and provides for the repayment of credit.

2. Establishing a Balance between Investment and Consumption

Perestroyka created considerable expectations for improvements in living standards. This has not occurred. The lines have lengthened before shops that appear to have less merchandise. Rationing has become more widespread, and in August 1989 limitations were imposed on the purchase of a range of consumer goods by non-residents in Moscow.

The statistical results of the first half of 1989 confirm these tendencies. Retail sales of bread, potatoes, vegetables, fish, and sugar declined and no change occurred in the production of meat and butter. Also, the production of many consumer durables, such as cars, motorcycles and sewing machines, fell (Wall Street Journal, August 30, 1989).

Part of the problem lies in the relative neglect of consumption in the 1986-90 Five Year Plan. According to the plan, the capital stock would increase by 30 percent in the 1986-90 period as against a rise of 17 percent in 1981-85 (Aganbegyan, 1988, p. 10). Hewett notes that "available data do not indicate precisely where the sacrifices are to be made, but probable targets are housing, the construction industry, and a broad category of 'other' in which most social infrastructure investment can be found" (1988, p. 317). Thus, the welfare consequences of the large investments extend beyond food.

Much of the new investment would go into machine building. According to Aganbegyan "in the Soviet machine building sector in the 1981-85 period only 9 percent of all equipment was renewed, while in the 1986-90 period 40 percent will be changed. This will mean a rise in the annual rate of planned renewal of the range of machinery produced from 3.1 percent in 1985 to 13 percent in 1990" (1988, p. 14).

The renewal of machinery is in fact an important objective, especially since Soviet machinery is much outdated compared with the West. But it is not sufficient to install modern machinery. In this connection, one may recall the example of Poland that spent large sums on modern machinery in the 1970s without commensurate results.

In the Polish case, the lack of a thoroughgoing economic reform was responsible for the lack of success of the machine building effort. Similar problems arise in the Soviet Union where an appropriate incentive system is lacking. Without such a system, the efficient utilization of machinery cannot be ensured.

These considerations indicate the desirability of a slowdown in the investment effort; since 1988 some steps have been taken in this direction but one would have much farther to go. This conclusion is strengthened if we consider the need to provide for consumer demand in the age of glasnost, when the deficiencies of the supply system are widely publicized. In fact, the dissatisfaction of the population threatens the success of perestroyka.

The first consideration is to provide sufficient food for the population. There were great expectations about the possibilities opened by the August 1988 decree that permitted the leasing of land to individual farmers up to 50 years. The Washington Post cited the Soviet news agency that foresaw "a new wave of the mass transfer of land and other means of production to leaseholders in the autumn and winter period of preparations for the new agricultural season" (August 27, 1988).

These expectations have not been realized and there has been little movement to lease land. Various considerations may explain this outcome. To begin with, there has been opposition on the part of sovhozes, kolkhozes, and the local authorities. Furthermore, agricultural machinery and materials have not been provided and the available machinery does not fit the needs of the smallholders. Last but not least, the experience of the 1930s and more recent reversals in the case of co-operatives have raised questions about the long-term future of this effort.

Yet, the long term leases deserve the full support of the government since they promise improvements in productivity. Further productivity improvements may be obtained by dividing the kolkhozes into smaller units and transforming the sovhozes into profit-making enterprises. At the same time, there is need to improve infrastructure, in particular the storing, processing, and transportation of food.

Satisfying the needs of the population would further require increased imports of consumer goods. This issue will be taken up below in connection with the need to eliminate the overhang in the market for consumer goods and services.

3. Eliminating the Overhang in the Market for Consumer Goods and Services

Limitations on the availability of goods and services led to the accumulation of fiancial savings in the Soviet Union. Thus, financial savings as a ratio of retail sales increased from 0.54 in 1978 to 0.81 in 1988 (*PlanEcon Report*, February 17, 1989).

This large amount of accumulated savings represents an overhang in the consumer market that is an inflationary force. In order to establish equilibrium in the market, it would be desirable to eliminate the overhang. Several measures may be taken to pursue this objective.

First of all, it would be desirable to increase the attractiveness of financial savings. This could be accomplished by raising interest rates on savings deposits and issuing bonds at attractive interest rates. Interest rates have remained unchanged at low levels in recent years despite increases in the underlying rate of inflation.

Second, it would be desirable to raise the prices of luxury and semi-luxury goods that are in short supply. The approximately eight year waiting period for automobiles could be reduced if prices were increased to levels where excess demand declines. Also, the prices of electronic goods could be raised.

Third, reductions in military spending would provide the opportunity to increase the production of automobiles and electronic goods. A shift from the production of military vehicles to that of automobiles could be accomplished relatively easily and military electronic goods could also be transformed into civilian goods.

Fourth, a substantial part of housing construction may be oriented towards the sale of houses and apartments to private individuals. This should involve the payment of advanced deposits that may also be used for the sale of automobiles.

Fifth, the population should be provided with increasing options for investment. This would permit channeling some of the financial savings into investment goods.

Sixth, the imports of consumer goods should be stepped up. Imports should concentrate on products that have a high domestic mark-up, such as electronic goods. This may make it possible to obtain 8-10 roubles per dollar.

Increased imports of consumer goods would involve external borrowing. This is made possible by the relatively low foreign indebtedness of the Soviet Union. The New York Times reports that at the end of 1988 the Soviet Union had an external debt of $43 billion, against which one should set deposits with Western banks of $28 billion and other foreign assets of $5 billion (July 31, 1989). The same issue of the New York Times quotas George Clark, the Executive Vice President of Citybank, according to whom "the Soviet Union could double its foreign debt today without raising any kind of concern." This would, however, necessitate the prompt servicing of the debt, the lack of which can adversely affect borrowing possibilities.

4. Reducing the Budget Deficit

For many years, the Soviet Union reported a balanced government budget. With glasnost, it has been made public that the Soviet Union has been incurring increasing budget deficits. The reported budget deficit averaged 20 billion rubles in 1980-85, 55 billion rubles in 1986, and 95 billion rubles in 1987 (The Economist, October 8, 1988). In August 1989, the Chairman of GOSPLAN reported that the projected 1989 budget deficit has grown 20 percent in six months to 120 billion rubles or 13.8 percent of the gross domestic product.

The rising budget deficit reflects rapid increases in current and capital expenditures and in subsidies, accompanied by little if any rise in revenues. A large item in current expenditure has been the acceleration of wage increases, rising by 7 percent in 1988, compared with a plan target of 2 percent (Financial Times, January 23, 1989) with a further increase of 9 percent in the first quarter of 1989, compared with a plan target of 1 percent for the entire year (PlanEcon Report, April 28, 1989). Capital expenditures reflect the expansion of investment under the 1986-90 plan. And, subsidies have risen both to finance the increasing losses of enterprises and to keep down food prices in the face of higher prices paid for agricultural produce. Finally, there have been unanticipated expenditures in connection with Chernobyl and the Armenian earthquake.

On the revenue side an important negative item has been the reduced revenue from taxes on alcohol, in conjunction with Gorbachev's anti-alcohol compaign. According to PlanEcon Report, official sales of alcohol declined by 11.6 percent in 1985, 10.6 percent in 1986, and 0.5 percent in 1987 (February 17, 1989). Also, revenues fell as a result of decreases in oil prices and the decline of profit remittances by the enterprises.

A variety of measures may be taken to reduce the budget deficit. These include price increases for luxuries and semi-luxuries, advance deposits on houses, apartments, and automobiles, and the sale of imported consumer goods at high prices, recommended for eliminating the overhang in consumer markets.

Furthermore, current expenditures could be reduced by limiting subsidies to loss-making enterprises, lowering food subsidies, restraining wage increases, reducing the size of the bureaucracy, and cutting military expenditures. In turn, the investment program should be cut by postponing large projects.

A leading candidate for cuts is the large petrochemical complex in Tiumen (Western Siberia). The planned investment in petroleum in Tanguin may also be postponed. Other candidates for cuts include investments in the production of fertilizers, in irrigation as well as the proposed metros in several cities.

The government may also introduce auctions of foreign exchange. Apart from increasing revenues, such auctions would contribute to the better allocation of foreign exchange and represent a first step towards the convertibility of the ruble.

IV. The Implications of Perestroyka for the European Socialist Countries

The success or failure of perestroyka will have an influence on economic reforms in the European socialist countries. Success will support the reform efforts of countries, such as Hungary and Poland, that have embarked on economic reforms, and may provide inducements to reforms in countries, such as Romania and Bulgaria. In turn, as Rezső Nyers, the President of the Hungarian Socialist Workers' Party, expressed it, "East European reforms will be influenced by setbacks of Soviet reform. ... A setback will have a limiting impact. It will warn everybody to be more cautious" (New York Times, January 5, 1988).

If perestroyka goes ahead, however imperfectly, it will have an influence on Soviet foreign trade. It is planned to increase the share of trade in national income, concentrating on raising manufactured exports while stabilizing the exports of fuels and raw materials (Ivanov, 1988, pp. 147-48).

But the expansion of Soviet trade would occur largely with the convertible currency area. Any increases in fuel and raw material exports will be sold for dollars. At the same time, there will be a tendency to shift purchases of manufactured goods from the CMEA countries to the convertible currency area where higher quality goods can be obtained. And, much of the expansion of imports will occur in high technology products that are largely provided by the convertible currency area.

The European socialist countries will also suffer a deterioration of their terms of trade. The Soviet Union will aim to obtain world market prices for its fuels and raw materials and to pay prices for manufactured goods that correspond to their quality.

On the other hand, the European socialist countries will benefit from greater freedom in trade flows. State-to-state contracts will increasingly give place to trade relations among enterprises that will reduce the existing rigidity of trade patterns.

Last but not least, the European socialist countries will have access to the large and growing market of the Soviet Union. But, in order to exploit the possibilities offered by the vast market, the quality of goods needs to be improved and product composition upgraded. This, in turn, requires far-reaching economic reforms in the European socialist countries.

V. Conclusions

This paper has provided a critical evaluation of perestroyka and noted its implications for the European socialist countries. After describing the main elements of the Soviet economic reforms, the paper indicated the micro- and macro-conditions for the success of the reforms.

As far as micro-conditions are concerned, emphasis has been given to the interdependence of rational prices, decentralization, profit maximization, incentives, and competition. For commodities that are produced domestically, the establishment of rational prices requires that prices equate demand and supply. This, in turn, necessitates the decentralization of decision making and profit maximization by the firm. At the same time, managers would have to be provided with appropriate incentives in order to ensure that firms maximize profits. Finally, there is need for competition to guarantee that profit maximization does not lead to the exploitation of monopoly positions and to inflation.

For perestroyka to succeed, certain macro-conditons would also need to be fulfilled. The government should aim at realistic growth rates, establish a balance between investment and consumption, eliminate the overhang in the market for consumer goods and services, and drastically reduce the budget deficit.

The discussion of the micro- and macro-conditions for the success of perestroyka indicated that the measures taken have not gone very far and have been characterized by lack of consistency. Much needs to be done, therefore, for perestroyka to be implemented in practice.

In 1989, some steps were taken towards the fulfilment of the macro-conditions in the framework of a stabilization program (Hewett, 1989) but these do not go very far. In April 1990, new reform measures have been announced to further the establishment of market conditions but their implementation is subject to considerable opposition.

At the same time, the success or failure of peretroyka will have implications for the success of reforms in the European socialist countries. And, the performance of these economies will be affected by the increased demands for quality by the Soviet Union. But, successful reform efforts on their part will help to meet this demand and to exploit the opportunities offered by the vast Soviet market.

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